FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 5133

TO ESTABLISH DOMESTIC CONTENT REQUIREMENTS FOR MOTOR VEHICLES SOLD IN THE UNITED STATES, AND FOR OTHER PURPOSES

SEPTEMBER 21, 22, 23, 24, 27, 28, 29, 30; AND OCTOBER 1, 1982

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FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

TUESDAY, SEPTEMBER 21, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:40 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[The press release announcing the hearings follows:]

[Press release of Sept. 20, 1982]

Hon. Sam M. Gibbons (D-Fla.) Chairman, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, Announces Hearings on H.R. 5133, the Fair Practices in Automotive Products Act, Beginning September 21, 1982

Hon. Sam M. Gibbons, Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will hold hearings beginning on September 21, 1982, on H.R. 5133, The Fair Practices in Automotive Products Act. The hearings will be held in room 1100 Longworth House Office Building, beginning at 9:30 a.m.

The Fair Practices in Automotive Products Act would establish minimum domestic content requirements for sales of motor vehicles in the United States. These requirements would have major implications not only for the United States automobile industry and its future competitiveness internationally, but for U.S. trading relations as well. The Subcommittee will address the question of likely implications for the domestic industry of establishing a local content scheme, as well as the implications for United States trade policy and our future trading relations with other countries.

Testimony will be received by invitation from an extensive group of witnesses who might be affected by this legislation, including representatives from the Administration, automobile manufacturers, business groups, organized labor, consumer groups, and agricultural groups. Representatives from the Administration will testify on September 21, 1982. Final witness lists, with starting time and location, will be made available in advance of each day's hearing.

Any interested person or organization may file a written statement for inclusion in the printed record. Persons submitting a written statement should submit at least six (6) copies by the close of business Tuesday, September 28, 1982, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may submit 50 additional copies for this purpose if provided to the Committee during the course of the public hearing.

Chairman **Gibbons**. Good morning, ladies and gentlemen.

As I think everyone knows, this is a meeting of the Trade Subcommittee of the Ways and Means Committee.

We are here today to begin public hearings on H.R. 5133, the auto domestic content legislation.

There are many problems with being old. One of the problems with being old is that you remember a lot of things and remember a lot of history, and I am going to refer to that in my opening statement.

This bill has to be the worst piece of economic legislation that this Congress has seriously entertained in 50 years. There could be no worse. I will elaborate on that as we go further into these hearings, but I want to make myself perfectly clear on this subject.

I am going to move these hearings as expeditiously as possible, and we have called and have received responses from a broad segment of the American economic public starting first with the administration; tomorrow the UAW and the chief sponsor of this bill, Mr. Ottinger, and other members of Congress, and following that we will hear from the automakers themselves, the chief executive officers of General Motors, Ford, Chrysler, American Motors, as well as the foreign manufacturers in this country.

I have insisted that chief executive officers attend personally and be subject to cross-examination, not just submit a statement.

We will also hear from the economic sectors of this country, those that are for and against this bill, and from all segments of Congress that want to hear it.

I do not know how long we will have temporary jurisdiction over this bill, but our jurisdiction is very short because of a mistake by the Parliamentarian.

This bill should have come first to the Ways and Means Committee and should have been thoroughly considered here before it was referred to any other committee. By mistake, the bill instead went to the Energy and Commerce Committee, and Ways and Means gets it as a sequential referral.

A sequential referral means that we get to wave at it as it passes by. Whether we report it favorably or unfavorably makes no difference. The bill goes to the floor in its proper order, although our report will have some weight, I guess; it will certainly weigh more than a couple of ounces anyway.

I regret that it is this late in the session that we have to start on this bill. It has laid around the Energy and Commerce Committee for over 1 year. It had all of 2½ hours of hearings, at which the proponents spoke. Since that time it has been the subject of extensive lobbying by everybody, and we finally get it here, but, as chairman, I will promise all members of this committee that we will give it a thorough and complete hearing.

[The bill, as sequentially referred to the Committee on Ways and Means, follows:]

97TH CONGRESS
2D SESSION

H. R. 5133

[Report No. 97–842, Part I]

To establish domestic content requirements for motor vehicles sold in the United States, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 8, 1981

Mr. OTTINGER (for himself, Mr. PEASE, Mr. BRODHEAD, and Ms. MIKULSKI) introduced the following bill; which was referred to the Committee on Energy and Commerce

FEBRUARY 23, 1982

Additional sponsors: Mr. KILDEE, Mr. BLANCHARD, Mr. YOUNG of Missouri, Mr. BONIOR of Michigan, Mr. BENJAMIN, Mr. HALL of Ohio, Mr. MITCHELL of Maryland, Mr. FROST, Mr. HERTEL, Mr. DAVIS, Mr. ADDABBO, Mr. RAHALL, Mr. FRANK, Mr. WON PAT, Mr. HUBBARD, Mr. LUKEN, Mr. VENTO, Mr. ALBOSTA, Mr. FOGLIETTA, Mr. FLIPPO, Mr. BAILEY of Pennsylvania, Mr. MURPHY, Mr. CROCKETT, Mr. SMITH of Pennsylvania, Mr. FORD of Michigan, Mr. STUDDS, Mr. FLORIO, Mr. EVANS of Indiana, Mr. HOYER, Ms. OAKAR, Mr. PURSELL, Mr. WASHINGTON, Mr. PERKINS, Mr. JACOBS, Mr. GEJDENSON, Mr. ANNUNZIO, Mr. TRAXLER, Mr. STOKES, Mr. FITHIAN, Mr. SKELTON, Mr. SHANNON, Mr. WILLIAMS of Ohio, Mr. OBERSTAR, Mr. WRIGHT, Mr. EDWARDS of California, Mr. CONYERS, Mr. APPLEGATE, Mr. JONES of North Carolina, Mr. DYSON, Mr. HOLLENBECK, Mr. MAVROULES, Mr. ECKART, Mr. ATKINSON, Mr. PEPPER, Mr. GRAY, Mr. LONG of Maryland, Mr. SHARP, Mr. SABO, Mr. GARCIA, Mr. ROGERS, Mr. BARNES, Mr. KOGOVSEK, Mr. WHITEHURST, Mr. DUNN, Mr. MOFFETT, Mr. ROYBAL, Mr. EARLY, Mr. SAVAGE, Mr. MOTTL, Mr. LAFALCE, Mr. MCEWEN, Mr. WOLPE, Mr. GINGRICH, Mr. GEPHARDT, Mrs. KENNELLY, Mr. MATTOX, Mr. PATTERSON, Mr. RATCHFORD, Mr. BEVILL, Mr. DYMALLY, Mr. WALGREN, Mr. PEYSER, Mr. SEIBERLING, Mr. SMITH of New Jersey, Mr. FARY, Mr. DIXON, Mr. ASPIN, Mr. HOPKINS, Mr. NOWAK, Mr. JAMES K. COYNE, Mr. DOUGHERTY, Mr. RINALDO, Mr. RUSSO, Mr. LEE, Mr. ENGLISH, Mr. NATCHER, Mr. NELLIGAN, Mr. COELHO, Mr. O'BRIEN, Mr. ROSENTHAL, Mr. HUGHES, Mr. GINN, Mr. MATSUI, Mr. FISH, Mr. MAZZOLI, Mr. WYLIE, and Mr. MINETA

September 21, 1982

Additional sponsors: Mrs. Schroeder, Mr. Guarini, Mr. Quillen, Mr. Volkmer, Mr. Watkins, Mr. Richmond, Mr. Shamansky, Mr. Lantos, Mr. Dwyer, Mr. DeNardis, Mr. Mollohan, Mr. Markey, Mr. John L. Burton, Mr. Solomon, Mr. Horton, Mr. Minish, Mr. Stratton, Mr. Leland, Mr. Edgar, Mr. Gaydos, Mr. St Germain, Mr. Jenkins, Mr. McKinney, Mr. Ertel, Mr. Snyder, Mr. Ford of Tennessee, Mr. Schumer, Mr. Moakley, Mr. Sawyer, Mr. Mica, Mr. Siljander, Mr. William J. Coyne, Mr. Dowdy, Mr. Boner of Tennessee, Mr. Jones of Tennessee, Mr. Yatron, Mr. Hillis, Mr. Boland, Mr. Dorgan of North Dakota, Mr. Clay, Mrs. Collins of Illinois, Mr. Downey, Mr. Rangel, Mr. Price, Mr. Fowler, Mr. Coughlin, Mr. Stark, Mr. Roe, Mr. Williams of Montana, Mr. Wilson, Mr. Tauzin, Mr. McDade, Mr. Daschle, Ms. Ferraro, Mr. Udall, Mr. Marks, Mrs. Heckler, Mr. D'Amours, Mr. Nichols, Mr. Conte, Mr. Madigan, Mr. Weiss, Mr. Courter, Mr. Duncan, Mr. Dingell, Mr. Dellums, Mr. Hamilton, Mr. Murtha, Mr. Brown of California, Mr. Goodling, Mr. Fauntroy, Mr. Staton of West Virginia, Mr. Zablocki, Mr. Latta, Mr. Zeferetti, Mr. Fazio, Mr. Gilman, Mr. Evans of Delaware, Mr. Ritter, Mr. Young of Florida, Mr. Winn, Mr. Shelby, Mr. Sam B. Hall, Jr., Mrs. Bouquard, Mr. Weaver, Mr. Roemer, Mr. Kastenmeier, Mr. Leach of Iowa, Mr. Obey, Mr. Smith of Alabama, Mr. Breaux, Mr. Fascell, Mr. Harkin, Mr. Simon, Mr. Long of Louisiana, Mr. Hawkins, Mr. Phillip Burton, Mr. Biaggi, Mr. Clinger, Mr. Wirth, Mr. Yates, Mr. Broomfield, Mr. Scheuer, Mr. Howard, Mr. Gonzalez, Mr. Shuster, Mr. Wortley, Mr. Martinez, Mr. Miller of California, Mrs. Boggs, Mr. Rose, Mr. Alexander, Mr. Brooks, and Mr. Lundine

September 21, 1982

Reported with an amendment, referred to the Committee on Ways and Means for a period ending not later than October 1, 1982, for consideration of such provisions of the bill and amendment as fall within the jurisdiction of that committee pursuant to clause 1(v), rule X

[Strike out all after the enacting clause and insert the part printed in italic]

[For text of introduced bill, see copy of bill as introduced on December 8, 1981]

A BILL

To establish domestic content requirements for motor vehicles sold in the United States, and or other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Fair Practices in Automotive Products Act".

SEC. 2. PURPOSE.

The purpose of this Act is to encourage the production of automotive products in the United States.

SEC. 3. DEFINITIONS.

(a) IN GENERAL.—As used in this Act—

(1) The term "automotive products" means motor vehicles and parts for use in the production of new motor vehicles.

(2) The term "added domestic value", when used with respect to a vehicle manufacturer for any model year, means the aggregate of—

(A) the production costs of all automotive products sold by the vehicle manufacturer in the United States, other than for export, during that model year, and

(B) the export value of all automotive products that were either—

(i) manufactured by the vehicle manufacturer in the United States and exported from the United States by, or on behalf of, such manufacturer during that model year, or

(ii) manufactured in the United States by any other person and purchased by the vehicle manufacturer and exported from the United States by, or on behalf of, such manufacturer during that model year, but only to the extent that the export value of such automotive products is not included in automotive products to which clause (i) applies;

reduced by the aggregate appraised value, as determined for purposes of the customs laws, of all automotive products that were entered by, or on behalf of, the vehicle manufacturer during that model year.

(3) The term "domestic content ratio" means, with respect to a vehicle manufacturer for any model year, the percentage determined by multiplying by one hundred the factor obtained by dividing—

(A) the added domestic value determined for that manufacturer for that model year under paragraph (2); by

(B) the production costs determined, for purposes of paragraph (2)(A), for that manufacturer for that model year.

(4) The term "entered" means entered, or withdrawn from warehouse for consumption, within the customs territory of the United States.

(5) The term "model year" means a vehicle manufacturer's annual production period (as determined by the Secretary) which includes January 1 of a calendar year, or if a vehicle manufacturer does not have an annual production period, the calendar year. A model year shall be designated by the year in which January 1 occurs.

(6) The term "motor vehicle" means any three-wheeled or four-wheeled vehicle propelled by fuel which is manufactured primarily for use on the public streets, roads, and highways (except any vehicle operated exclusively on a rail or rails), and which is rated at ten thousand pounds gross vehicle weight or less. Such term does not include (A) any motorcycle, or (B) any vehicle determined by the Secretary to be an automobile capable of off-highway operation within the meaning of section 501(3) of the Motor Vehicle Information and Cost Savings Act.

(7) The term "production cost" means, with respect to an automotive product, the wholesale price to dealers in the United States for that product as set forth in the vehicle manufacturer's official dealer price list that is in effect at the time the product is sold at wholesale.

(8) The term "Secretary" means the Secretary of Transportation.

(9) The term "vehicle manufacturer" means any person engaged in the business of producing motor vehicles for ultimate retail sale in the United States and includes as one entity all persons who control, are controlled by, or are in common control with, such person. Such term also includes any predecessor or successor of such a vehicle manufacturer.

(b) DETERMINATION OF ADDED DOMESTIC VALUE.—For purposes of applying paragraph (2) of subsection (a)—

(1) Two or more vehicle manufacturers may not include, for purposes of determining their respective added domestic values, the value of the same automotive product; but such manufacturers may, under rules prescribed under section 4(b), apportion the value of that automotive product among them.

(2) The term "export value" means, with respect to an automotive product—

(A) the free-on-board price for which the vehicle manufacturer sells the product for exportation from the United States; or

(B) if the vehicle manufacturer sells the product for such exportation to a buyer that con-

trols, is controlled by, or is under common control with, such manufacturer, the price at which such or similar products are freely offered for free-on-board sale to all purchasers in the principal markets of the United States in the usual wholesale quantities and in the ordinary course of trade for such exportation.

(3) Any automotive product that is entered by a person other than a vehicle manufacturer shall, if such product is purchased or otherwise acquired by the manufacturer (and whether or not used in the fabrication of another automotive product which is acquired by that manufacturer), be treated as having been entered by that manufacturer.

SEC. 4. CONTENT RATIOS FOR MODEL YEAR 1984 AND THEREAFTER.

(a) RATIOS.—For each model year beginning after January 1, 1983, the minimum domestic content ratio for a vehicle manufacturer shall not be less than the higher of—

(1) the domestic content ratio achieved by the vehicle manufacturer in model year 1983 reduced by 10 per centum; or

(2) the applicable minimum content ratio specified in the following table:

Number of motor vehicles produced by the manufacturer and sold in the United States during such year	*Minimum domestic content ratio*
Model Year 1984	
Not over 100,000	*0 percent.*
Over 100,000 but not over 900,000	*The number, expressed as a percentage, determined by dividing the number of vehicles sold by 30,000.*
Over 900,000	*30 percent.*
Model Year 1985	
Not over 100,000	*0 percent.*
Over 100,000 but not over 900,000	*The number, expressed as a percentage, determined by dividing the number of vehicles sold by 15,000.*
Over 900,000	*60 percent.*
Each Model Year After Model Year 1985	
Not over 100,000	*0 percent.*
Over 100,000 but not over 900,000	*The number, expressed as a percentage, determined by dividing the number of vehicles sold by 10,000.*
Over 900,000	*90 percent.*

(b) ALLOCATION OF AUTOMOTIVE PRODUCTS AMONG MANUFACTURERS.—In order to carry out the purpose of this Act, the Secretary shall prescribe rules for allocating automotive products among vehicle manufacturers in appropriate cases such as where—

(1) a vehicle manufacturer sells automotive products manufactured by it in the United States to another vehicle manufacturer;

(2) two or more vehicle manufacturers in joint venture produce automotive products in the United States; and

(3) a vehicle manufacturer produces motor vehicles for ultimate retail sale in the United States, some

of which will be sold by that manufacturer and some by another vehicle manufacturer.

SEC. 5. INFORMATION AND REPORTS.

(a) VEHICLE MANUFACTURERS RECORDS AND INFORMATION.—Each vehicle manufacturer that produces more than one hundred thousand motor vehicles for sale in the United States during any model year after model year 1982 must establish and maintain such records, and provide such information, regarding the production and sale of automotive products by it as the Secretary by rule shall require for purposes of carrying out section 4(a) and the enforcement provisions of section 6.

(b) AUTHORITY TO OBTAIN INFORMATION.—(1) The authority granted to the Secretary under subsection (b)(1) of section 505 of the Motor Vehicle Information and Cost Saving Act (as in effect on the date of the enactment of this Act) to obtain information and data, and access thereto, that is deemed advisable by him for purposes of carrying out part V of that Act may be used by the Secretary for purposes of obtaining the information and data, and access thereto, that is necessary or appropriate to carry out section 4(a) and section 6.

(2) The authority granted to the districts courts of the United States under subsection (b)(2) of such section 505 to enforce compliance with action taken by the Secretary under

subsection (b)(1) of such section may be used by such courts to enforce actions taken by the Secretary pursuant to paragraph (1) for purposes of carrying out this Act.

(3) The Secretary shall disclose any information and data obtained under this subsection and subsection (a) to the public only in accordance with section 552 of title 5, United States Code; and any matter described in subsection (b)(4) of such section shall not be disclosed to the public, except that where such matter may be relevant to any administrative or judicial proceeding to enforce this Act, such matter may be disclosed in such proceeding only in a manner which would not result in competitive damage or disadvantage, as determined by the Secretary or a court, because of such disclosure.

(c) ANNUAL REPORTS.—As soon as practicable after the close of each model year after January 1, 1983, the Secretary shall prepare and make available to the public a report setting forth the domestic content ratio achieved by each vehicle manufacturer during such model year.

SEC. 6. ENFORCEMENT.

(a) FAILURE TO MEET CONTENT RATIOS.—(1) It is unlawful for a vehicle manufacturer to fail to meet for any model year the applicable minimum domestic content ratio required under section 4(a).

(2) If the Secretary finds, after notice and an opportunity for a hearing in accordance with section 554 of title 5,

United States Code, that a vehicle manufacturer has violated paragraph (1), the Secretary shall issue an order prohibiting the vehicle manufacturer from entering, or having entered on its behalf, during the twelve-month period beginning on the date on which the finding becomes final—

(A) a quantity of motor vehicles that exceeds the total quantity of motor vehicles that was entered by, or on behalf of, that manufacturer during the model year in which such violation occurred reduced by the number of motor vehicles that bears to such total quantity the same percentage by which the vehicle manufacturer failed to meet the domestic content ratio for that model year; and

(B) parts for motor vehicles in an aggregate value (as appraised for purposes of the customs laws) that exceeds the total aggregate appraised value of parts for motor vehicles that were entered by, or on behalf of, that manufacturer during the model year in which such violation occurred reduced by parts of an aggregate value that bears to such total aggregate value the same percentage by which the vehicle manufacturer failed to meet the domestic content ratio for that model year.

(3) An order issued pursuant to paragraph (2) shall specify the total number of motor vehicles and the aggregate

appraised value of parts for motor vehicles that may be entered during the applicable twelve-month period by, or on behalf of, the vehicle manufacturer. The Commissioner of Customs shall take such action as may be necessary to ensure that the entries made by, or on behalf of, the vehicle manufacturer during such twelve-month period do not exceed the limits specified in the order.

(4) Any person against whom an order is issued under paragraph (2) may, within sixty calendar days after the date of the order, institute an action in the United States court of appeals for the appropriate judicial circuit for judicial review of such order in accordance with chapter 7 of title 5, United States Code. The court shall have jurisdiction to enter a judgment affirming, modifying, or setting aside in whole or in part, the order of the Secretary, or the court may remand the proceeding to the Secretary for such further action as the court may direct.

(b) OTHER VIOLATIONS.—(1) Any person who knowingly violates any provision of this Act (other than failure to meet the applicable domestic content ratio for any model year) or any rule or regulation issued under this Act shall be liable to the United States for a civil penalty of not more than $10,000. Each day of a continuing violation under this subsection shall constitute a separate offense.

(2)(A) Before issuing an order assessing a civil penalty against any person for violation of paragraph (1), the Secretary shall provide to such person written notice of the proposed penalty.

(B) The Secretary shall promptly assess such penalty, by order, after the date of the receipt of the notice under subparagraph (A) of the proposed penalty.

(C) If the penalty has not been paid within sixty calendar days after the assessment order has been made under subparagraph (B), the Secretary shall institute an action in the appropriate district court of the United States for an order affirming the assessment of the civil penalty. The court shall have authority to review de novo the law and the facts involved, and shall have jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part, such assessment.

(D) If any person fails to pay an assessment of a civil penalty after the appropriate district court has entered final judgment in favor of the Secretary under subparagraph (C), the Secretary shall institute an action to recover the amount of such penalty in any appropriate district court of the United States. In such action, the validity and appropriateness of such final assessment order or judgment shall not be subject to review.

(3) The Secretary may compromise, modify, or remit, with or without conditions, any penalty that is subject to imposition or that has been imposed under this subsection.

SEC. 7. STUDY OF DISCRIMINATORY PRACTICES AFFECTING DOMESTIC PRODUCTION OF MOTOR VEHICLE PARTS.

Within one year after the date of the enactment of this Act, the Secretary and the Federal Trade Commission shall jointly undertake an investigation, and submit to Congress a written report, regarding those policies and practices of vehicle manufacturers that are used to persuade United States motor vehicle dealers, in chosing replacement parts for motor vehicles, to favor foreign-made parts rather than domestically produced parts. Such report shall include, but not be limited to, recommended administrative or legislative action that the Secretary and the Federal Trade Commission consider appropriate to assure that domestic producers of replacement parts are accorded fair access to the United States market for such parts.

SEC. 8. GAO REPORT.

Not later than one year after the date of the enactment of this Act and each year thereafter, the Comptroller General of the United States shall transmit to the Congress a report on the impact of this Act on the automotive and related industries in the United States. Each report shall contain an anal-

ysis of the impact of this Act during the period for which the report is submitted—

(1) on the prices of new, domestic and foreign motor vehicles;

(2) on the employment within the United States in motor vehicle manufacturing and in related industries and on employment in the United States in export industries;

(3) on the productivity and profits of vehicle manufacturers who have sales of their motor vehicles in the United States;

(4) on the productivity and profits of foreign vehicle manufacturers who have production facilities in the United States; and

(5) on the development of motor vehicles suitable for use in more than one country.

Each report shall also contain recommendations for such legislation as the Comptroller General determines is appropriate.

Chairman GIBBONS. Of course, as all chairmen, I am directed by the members of the committee and subject to their will, so if any of you disagree with the way we are doing this, I wish you would let me know. Would any other member like to make a statement before we begin? Mr. Frenzel.

Mr. FRENZEL. Mr. Chairman, it is my understanding that the bill is not before the committee at this time, has not been filed by Energy and Commerce.

Chairman GIBBONS. That is correct, but I made a commitment the other day that I would start and there would be no delay, and there will be no delay.

I am sorry the Energy and Commerce Committee is still monopolizing this bill.

Mr. FRENZEL. Mr. Chairman, may I be recognized for a short statement?

Chairman GIBBONS. Certainly.

Mr. FRENZEL. My feelings on this bill are not much different than your own and I am particularly concerned that this committee has not been able to exercise its legitimate jurisdiction.

I don't think the end of that problem has been heard from yet. It is my intention too to see that this bill gets all of the hearing that is necessary.

When you have a large turkey, there are lots of feathers that have to be examined before this committee should make a decision one way or the other, and I personally will be very concerned if we do not have a number of days of hearing on this subject and exhaust the list of potential witnesses.

I think that this committee getting this bill, which was introduced over 1 year ago, at this stage of the session is a bad thing for the committee, a bad thing for House procedures, and I hope that we will do it justice; and I am delighted with the chairman's attitude.

I yield the balance of my time.

Chairman GIBBONS. Mr. Brodhead.

Mr. BRODHEAD. Thank you, Mr. Chairman.

Mr. Chairman, you and I have discussed this issue over the past 1½ to 2 years, and we are well aware of each other's feelings on it. I know the chairman feels very sincerely that this legislation is not in the interests of our country. I feel just as sincerely that it is.

I am not going to take issue with the chairman. There is not much point in that. I do think that to make the statement, however, that this is the worst piece of legislation ever before the Congress in 50 years, is a very broad statement indeed.

I certainly can think of some colossal errors that this Congress has made in the relatively brief time that I have been in it, some of which I voted for and some of which I didn't.

I think the legislation is, Mr. Chairman, a well-considered and well-thought-out effort to deal with one of the most serious problems that we have in our country, and to deal with it in a way that does not diminish competition.

Again I want to recognize that the chairman, despite his views on this, has committed himself to a thorough airing of these issues, a thorough discussion of it, and I appreciate the chairman's commitment in that regard, and pledge to work with the chairman to see if we can't arrive at some sensible conclusions here.

Chairman GIBBONS. Fine.

Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Mr. Chairman, in an ideal world, or certainly in an environment of fair trade, marketing, investment regulation, and laws around the globe, this piece of legislation would probably not even draw serious attention.

I don't think anyone who viewed the world in terms of what free enterprise or some reasonable facsimile thereof, or what that term really means, would seriously consider this bill, but I think we ought to step back for a moment and take a perspective that is more realistic.

This bill is getting the attention that it deserves, and it is getting support that it deserves, because it has been brought to public attention at the apex of a long string of abuse.

Perhaps somebody, and it is not this administration incidentally—I see Ambassador Brock sitting there—it is not fair to say that this particular Reagan administration is somehow responsible for that long historic string of abuses to which American industry and American labor and American markets have been subjected.

Perhaps if someone could sit down with the, I am sure, well-intentioned Japanese, for example, and try to impress upon them the importance of doing business in a little more fair way, or with some of our other more immediate trade partners, this legislation wouldn't even be seriously considered. But it is seriously being considered because it is a typical American open and honest way to respond to practices on the part of other nations, and I have felt that personal sting at home in my district. They are not fair, so we attempt to codify what others do behind closed doors, and we attempt to bring out in the open and write into law what others do with planning policies.

Now, in an ideal situation it perhaps is not the best alternative, but I hope it gets a good go, and somebody had better wake up and listen.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you.

We have before us this morning three witnesses from the administration. We have Ambassador Brock, Secretary Baldrige and Deputy Secretary of the Treasury, Mr. McNamar.

Gentlemen, we are anxious to hear from you.

Before I recognize Ambassador Brock, I want to say that I contacted Ambassador Mansfield for his views on this subject. I have before me a partially handwritten, partially typewritten personal letter from former Senator Mansfield, the majority leader of the Senate, our longtime Ambassador to Japan, an expert on the Far East, China included, in which he roundly condemns this legislation, and I think one part of it I should read and the rest of it I will put in the record at the appropriate place.

He says on page 2, paragraph 2:

> As bad as the effects of such legislation would be on the economic side, the damages unfortunately would not be confined to that. The Government of Japan and the Japanese people would clearly question the value of having an ally that would take

such an action against them. The ties between Japan and the United States could weaken significantly, affecting with unpredictable consequences our political and security relationships in ways that could go far beyond Japan.

Here is a man who spent most of his adult life in the U.S. Senate, was a majority leader of the Senate, probably one of the finest members the Democratic Party has produced in many a generation, and he knows firsthand of the situation in the Asian areas. I do not know that we have such expertise in Europe, but I am sure it is there. I am just not personally acquainted with it.

[The letter referred to follows:]

TOKYO, JAPAN, *September 15, 1982.*

Hon. SAM GIBBONS,
Chairman, Subcomittee on Trade,
Washington, D.C.

DEAR SAM: Before leaving Tokyo, I received a call from a member of your staff that you requested my views on "local content" legislation. I am most happy to comply.

I appreciate your giving me the opportunity to comment on H.R. 5133, the automobile local content bill. In terms of its possible impact domestically and internationally, it is, I believe, a misguided attempt to solve a serious problem. It is my opinion that passage of such legislation would be damaging to the world trading system, and a signal to our trading partners that the United States is abandoning the free-trade philosophy that has been a cornerstone of the postwar trading system. Though it is called a job creation bill, rather than encouraging foreign investment in the U.S. auto industry and new employment, it would discourage new investment and damage operations of existing plants. In the context of United States-Japan relations, such a bill would effectively put an end to the market liberalization measures that have been going on for the past year in response to efforts by the United States and the European countries.

I would like first to address the legislation's possible impact on U.S.-Japan relations. Since content legislation is clearly GATT-illegal, Japan would be entitled to retaliate, and I think we have to expect it would do so. The trade value of 1.2 million automobiles would leave a very large scope for retaliation, and could touch a number of sensitive products such as petrochemicals, aluminum, high technology goods, beef, citrus, tobacco, leather, processed foods, and perhaps such big ticket items as feed grains and coal, where the Japanese would undoubtedly look for other sources of supply. Such restrictions would obviously cause dislocations and, in the U.S., the loss of jobs. In the second instance, passage of such legislation would undoubtedly lead to a strenthening of "traditional" Japanese attitudes that, while exports are good, imports are not. There would be much damage to the Japanese commitment to the international trading system, and Japanese confidence and trust in the U.S. market and U.S. economic policy would be seriously weakened.

As bad as the effects of such legislation would be on the economic side, the damage unfortunately would not be confined to that. The GOJ and the Japanese people would clearly question the value of having an ally that would take such an action against them. The ties binding Japan to the U.S. could weaken significantly, affecting with unpredictable consequences our political and security relationships in ways that could go far beyond Japan.

In addition to the harm to the U.S.-Japan relationship that I have just described, I seriously doubt that, in the long run, the legislation would achieve its stated goal of increasing employment in the auto sector. A more positive method of increasing U.S. employment and decreasing bilateral trade frictions is to encourage Japanese auto companies to invest in the United States. Honda and Nissan have established plants and Toyota is actively considering investment. Local content legislation would threaten all such investment plans, and perhaps force existing plants to close, since they operate with imported components. The Japanese companies have indicated their intention to increase local sourcing for autos produced in the U.S.; this is the trend we should encourage. We should also encourage Japanese manufacturers to certify U.S. made parts for use in Japanese cars repaired in the U.S.

There are several factors that will affect the ability of U.S. auto manufacturers to regain their competitive position in the world market. The first, of course, is overall economic recovery and a decline in high interest rates, without which the market for all automobiles cannot prosper. A second factor would be a renewal of our commitment to quality and productivity by both management and labor. I am encouraged by indications that this renewal is underway. Moderation of prices, too, is taking place, as shown by the recent General Motors announcement of price decreases on many models. Labor unions, through realistic restraint in recent wage talks; management, through emphasis on quality in design and manufacture; and the willingness of both sides to cooperate in achieving a quality product will go a long way to making American made automobiles competitive again.

Conversely, local content legislation, by offering protection to American auto companies, would reduce price competition and thereby reduce the incentive for American companies to innovate and economize. The winner—in the very short run—might be the American auto worker. The losers would be the American consumer, the American worker in export oriented industries, and in the longer run, probably the auto workers as well. Artificial trade barriers cannot provide a lasting solution to economic difficulties; management and labor cooperation to build a good, competitive auto, and the recovery of the U.S. economy must be our goals.

With best personal wishes, I am,

Sincerely yours,

MIKE MANSFIELD, *Ambassador.*

Chairman GIBBONS. I would like now to recognize Ambassador Brock.

STATEMENT OF AMBASSADOR WILLIAM E. BROCK, U.S. TRADE REPRESENTATIVE

Ambassador BROCK. Thank you very much, Mr. Chairman. With your permission I will submit a fairly extensive statement for the record and try to summarize it.

Chairman GIBBONS. I would like to have you cover it as thoroughly as you wish because I am here to listen.

Ambassador BROCK. I appreciate your attention, Mr. Chairman. We share a view of this particular legislation.

In my own testimony I drew an analogy between this and the Burke-Hartke bill of a decade ago, but I think you could also draw an appropriate analogy between this and the Smoot-Hawley tariff of 1930.

One failed, the other passed. The one that passed had the effect of extending the depth and the duration of the greatest depression of this century.

I fear that this bill has a similar content, not that it is not well intended, not as the gentleman has said that it is not an honest effort to respond to some egregiously bad practices on the part of others, but simply because it won't work.

There are a lot of countries in this world that are having economic difficulties. The problem is that when countries have those difficulties, we are tempted to turn in all free societies to a short-term solution of saving jobs at home by keeping out products from abroad, but increased trade expands domestic employment in every country and decreased trade shrinks employment in every country.

The supporters of this bill must acknowledge that H.R. 5133 would trade off jobs in factories that make goods for export, against jobs in other factories that make import competing goods. In manufactured goods like aircraft, agricultural and construction equipment; industries whose workers belong to the same union as the autoworkers, we had a trade surplus with the world of almost $12 billion. Between 1977 and 1980 four out of five of all new manufacturing jobs were created in export industries. Those jobs would not be in place today and those workers would not be working had this bill been enacted into law in 1977.

The administration must reject the protectionist approach of H.R. 5133. We are, however concerned with the very real problems faced by the U.S. automotive industry, its suppliers and their workers.

The import penetration did reach a record 32.8 percent in August but I think it is important to point out that import sales, in absolute terms are running only 200,000 units more this year than 5 years ago when the import penetration ratio was 18.4 percent.

In so many words, we have had a decline in U.S. domestic production, not an increase in imports. It is the decline that is causing the problem for our workers and for our country.

In previous hearings on the automotive issue, one of the points on which most parties seemed to agree was that imports were no longer the immediate problem of the American auto industry. This lowered concern over imports was reinforced by the unilateral 3-year export restraint on automobiles which was announced by the Government of Japan on May 1, 1981. In March of this year the Japanese Government announced that these restraints would be continued through March 1983 at the same levels as the previous year.

We welcome the restraint which rolled back the number of cars the Japanese were selling in the United States by about 7 percent. This assures that virtually every additional car that is sold in the United States during the period of these restraints will be manufactured in North America. I particularly believe that the Japanese voluntary action is effectively meeting the import problem without permanently damaging the trading system, U.S. exports and jobs, as would domestic content legislation. Conversely, enactment of H.R. 5133 could lead to the immediate termination of this restraint, raising the possibility of a severe negative impact on our auto workers between now and late 1984 when the bill would go into effect.

I think the essence of what I have just said, Mr. Chairman, is that the bill doesn't deal with the problem. The problem is our domestic circumstance. The problem has been interest rates ranging from presently 13.5 percent back to 21.5 percent just 2 years ago. The problem has been a recession that is worldwide, a credit crunch that is worldwide.

Let me now turn specifically to the international trade consequences of this proposed legislation. Let there be no mistake, the new version of H.R. 5133 would be directly contrary to the requirements of articles III and XI of the General Agreement on Tariffs and Trade, which provides for national treatment under domestic laws and prohibits quantitative restrictions respectively.

Should our foreign trading partners respond to the illegal U.S. trade actions mandated by this bill by retaliating against our leading exports, such as computers, aircraft, semiconductors or agricultural products, or any of a number of others, the cost to the employment and economic well-being in our economy is considerable.

Proponents of the bill argue that the new version would effectively exclude all countries except Japan and Canada from the immediate effects of local content legislation. They argue further that Japan, because of its large trade surplus with the United States and the importance of the U.S. auto market to Japan would comply with the local content regulations and not retaliate.

I don't agree, but even if it were so, the negative precedent by the United States, the world's strongest economy, in blatantly violating our own national commitments, will lead to the emulation of our actions by other major trading countries. While a number of countries already maintain performance requirements in automotive and other sectors, these are almost exclusively developing countries and they do so to their own economic detriment. The net result of protectionist policies for developed and developing countries alike is lower output, fewer jobs, and ultimately economic stagnation.

Mr. Chairman, if I may parenthetically inject at this point a suggestion that it might be helpful for us to look at the experience of other countries who have done this, Australia, Brazil, a number of others, and study just how severely the consumers and the workers of those countries have been impacted by the negative effect of this kind of approach, it doesn't work.

With reference to Canada, our largest trading partner, the new version of H.R. 5133 would subject automotive exports from Canada to the same domestic content requirements as those from other countries. This would be both contrary to the rules of the GATT and the United States-Canadian Automotive Products Agreement. The bill would be an incentive for U.S. producers to maximize net exports of automotive products to Canada in order to meet more easily the mandated domestic content ratio. In the past the Canadian Government has indicated its displeasure at the continued bilateral deficit in trade that Canada has had under the Auto Trade Pact and its desire to achieve a fairer balance of bilateral trade. If this bill is enacted, it could be reasonably anticipated that the Canadian Government would respond with mirror image legislation or other retaliation designed to achieve both its goal of balanced trade and of neutralizing the export incentives contained in H.R. 5133. If this came about, it would mean a transfer of jobs from the United States to Canada, and a further drag on efficiency of production in the total North American market.

We do believe that trade is a two-way street. If the United States is going to keep its market open, if this administration and Congress are to accept the political bruises of doing what is in the national economic interest by fighting protectionism; then we can expect nothing less from our major trading partners.

With respect to Japan, the concerted efforts of the United States can no longer be measured just in verbiage, but must achieve concrete results.

With respect to Canada, we have formally challenged the domestic sourcing requirements promulgated by the Canadian Foreign Investigating Review Agency. Believing the Canadians are not fulfilling their objections, we have submitted this to a GATT panel. We believe we have a solid case. A firm decision will strengthen our hands in dealing elsewhere in the world.

At the GATT ministerial in November, we hope to launch a serious work program on the trade implications of investment requirements with the ultimate aim of checking the use of local content and export requirements, multilaterally.

In sum, this bill is another manifestation of an affliction that Americans want left behind, the easy answer. We are tired of quick solutions that invariably become nonsolutions resulting from a simplistic analysis of problems. Increased imports share is not the problem, but rather a symptom of a decline in U.S. international competitiveness in a few selected priority areas.

In contrast, the bill creates serious new problems. It would be viewed as both a renunciation of reciprocal trade liberalization policy currently being pursued by this administration and a revocation of free trade policy that has been supported by all administrations and all Congresses for over 30 years.

If Congress were to proceed with this legislation, our efforts to launch initiatives at the November GATT ministerial meeting in Geneva, particularly in services, high technology and agriculture, aimed at opening and improving the trading system to the benefit of this and all nations, are bound to be met with failure.

Mr. Chairman, if I can again depart just parenthetically from the text of these remarks to mention the real concern that I have. As I said at the outset, it seems to me that when we get into economic diffculty it is particularly tempting, first of all, to blame someone else for our problems. If we do so, if we accept that temptation, it simply means that we don't face our problems and deal with them. That is the first.

Second, by taking a single shot approach to deal with one particular problem in one industry that is not externally generated, we run a second risk that is of I think potential enormous political consequence because this bill asks the Congress to authorize this Government to choose one industry over another and to discriminate against the other.

I know that politically when a country has a pie that is not growing, there is a temptation to try to get their share of the pie first, and maybe for some to get a little more. The automotive industry has not had an adequate share of the pie. They have a serious, serious problem. There are a quarter of a million direct workers out of work at the moment. It is a major responsibility of this Government, Congress, and the administration, to do as best we can to give them an opportunity to become productive again.

But, to do so as the bill suggests by trading the job of a person in one industry against the job of another can only increase the strain and the tension upon our domestic fabric. Because every industry then would try to make the same case, and if they did, we would be in a position of everybody trying to grab pieces out of the pie without regard to the well-being of their neighbor.

We don't have that kind of a country and we must not ever have it. The basic function of any government is to try to expand the economic opportunity for all, not to select some to the disadvantage of others. That, to me, is the basic concern of this bill.

I would like to conclude by quoting a study on performance requirements that was done by the Labor-Industrial Coalition for International Trade. That is not a theologically rigid free trade organization. Its members include steel companies, textile workers unions, communication workers unions, electrical unions, the Flint Glass Workers Union, the Industrial Union Department of the AFL-CIO, International Ladies' Garment Workers Union, International Association of Machinists, Steelworkers, and others in a number of major corporations, and these are their words, Mr. Chairman, not mine, but I endorse them completely.

> Trade distorting performance requirements result in a direct transfer of investment jobs and production to the country which imposes them away from other countries. International shifts in investment, employment, production and trade which they cause are not a response to market forces. Rather, they are the result of government fiat. Their purpose is to increase the economic welfare of the country imposing such measures directly at the expense of other countries, a new form of "beggar thy neighbor" policy. The United States should not hesitate to pursue the remedies available under international agreements to challenge these unfair discriminatory practices. If we fail to act, we may through silence legitimize these practices and thus contributre to their proliferation.

Mr. Chairman, this study is an excellent piece of work. It was published in March 1981, just a little over 1 year ago, and under the signature of Amory Houghton, chairman of Corning Glass Works, and Howard Samuel, president of the Industrial Union Department of the AFL-CIO. And I submit it is worth reading for all members, those who are seriously concerned about issues on either side.

Thank you for the chance to participate.

Chairman GIBBONS. Thank you, sir.

[The prepared statement follows:]

STATEMENT OF AMBASSADOR WILLIAM E. BROCK, U.S. TRADE REPRESENTATIVE

Mr. Chairman and members of the subcommittee, in the past I have publicly stated that this bill, misleadingly titled "The Fair Practices in Automotive Products Act", is the worst threat to our own prosperity and the international trading system to be put before Congress in a decade—since the "Foreign Trade and Investment Act of 1972," the "Burke-Hartke Bill." After reviewing the new substitute version reported out by the full Committee on Energy and Commerce, yesterday, I see no reason to recant nor even soften these remarks.

H.R. 5133 and the "Burke–Hartke" bill have much in common. Both would place quotas on imports. H.R. 5133 would enforce domestic content ratios in the auto industry through quotas; "Burke-Hartke" would have placed virtually all U.S. imports under quotas where there was some domestic substitute source available. H.R. 5133 is touted as a jobs bill with strong support from organized labor, and so was "Burke-Hartke". H.R. 5133 is also being pushed by many co-sponsors in an election year as a political issue, as was Burke-Hartke. Burke-Hartke was rejected as protectionist legislation which would have cause irreparable damage to the United States and world economies, and H.R. 5133 is just as protectionist and harmful and, I predict, will ultimately be defeated.

Today the nations of the world, including ours, are beset with economic difficulties. National economies, in many instances very fragile, are tempted to turn to the short-term solution of saving jobs at home by keeping out products from abroad. However, increased trade expands domestic employment in every country and decreased trade shrinks world employment.

Let us view this issue, for a moment, just from the perspective of the self interest of our own nation. Last year, The United States imported 260 billion dollars worth of goods, such as oil, chromium, bauxite, bananas and many other items for which there is insufficient or no domestic supply. In total, we imported 30 billion dollars more than we exported. We largely paid for our imports through net surpluses in agricultural products, services, and manufactured goods. In manufactured goods like aircraft, agricultural and construction equipment,—industries whose workers belong to the same union as the auto workers—we had a trade surplus with the world of almost 12 billion dollars. Between 1977 and 1980, four out of five of all new manufacturing jobs were created in export industries. Had we passed local content legislation in 1977, these jobs would not exist today. Such legislation would have led to foreign retaliation, less trade and fewer jobs, both here abroad.

The supporters of this bill must acknowledge that it would trade off jobs in factories that make goods for export, against jobs in other factories that make import-competing goods. The Administration must reject this approach. At the same time, we are greatly concerned with the very real problems faced by the U.S. automotive industry, its suppliers and their workers.

The American automotive industry is, in fact, in its worst slump in over 20 years. Through August of 1982, new car sales by domestic manufacturers were 3¾ million units, down 14 percent from the already depressed sales levels in the same period in 1981. Approximately 220,000 auto workers are on indefinite layoff, and the unemployment rate for workers making autos, auto parts and components was estimated by the Bureau of Labor Statistics at 19.2 percent during August of this year, which is double the national average. Both of these numbers are undoubtedly underestimated due to the exclusion of workers losing recall rights and discouraged workers dropping out of the labor force.

While import car sales in the first eight months of 1982 compared with the same period in 1981 also declined, down 11 percent, import penetration rose slightly from 27.6 to 28.4 percent as the fall-off in import sales was less than that for domestic autos. As you are aware, in August import penetration reached a record 32.8 percent. In absolute terms, however, import sales are running only 200,000 units more this year than five years ago when the import penetration ratio was 18.4 percent. Meanwhile sales by U.S. manufacturers decreased by over three million units. These losses in relative market share and the decline in absolute sales by the U.S. auto industry are symptoms of a much larger problem facing the United States. Automobiles are the largest users of petroleum in this country, accounting for approximately 40 percent of consumption. Consequently, sporadic petroleum shortages and past enormous price increases have had their impact on the automotive industry, its workers and suppliers. United States automobile manufacturers were largely unprepared for the oil crisis of 1979 with the accompanying student swing in demand for energy-efficient automobiles. Without placing blame on company management for wishful thinking on the prospects for continued sales of large cars or on government for distorting market signals by maintaining oil price controls, the simple fact was that there was excess demand for small energy-efficient cars in 1979 and 1980 and insufficient American capacity.

Today the problems facing the American automotive industry and the country as a whole have changed. The automotive industry has largely made the transition to smaller fuel-efficient automobiles. Corporate average fuel economy exceeds the Federal standards.

This had been at an enormous investment cost that has contributed to large corporate losses and has left the individual companies unequally situated in competitive ability and financial strength. The U.S. "big four" auto companies in 1981 has a combined $7.5 billion negative cash flow from operations and were $13 billion in debt. The country as a whole has slipped into a recession, responding negatively to years of inflation and high interest rates. For durable goods like automobiles, high interest rates and lagging income have had a disproportionately negative effect upon demand.

The present depressed state of the domestic automotive industry, irrespective of the specific economic causation, is a matter of concern to most Americans, and particularly to this Administration which continues to try to reach long-term solutions to the nation's pressing economic problems. Last year, a Presidential program for assisting the domestic auto industry was announced. Among other features, this program seeks to reduce industry capital costs and car prices to consumers by reducing excessive regulatory burdens. However, the cornerstone of the President's initiative for the auto industry was and remains his Economic Recovery Program. To quote the Presidential statement, "There is simply no doubt that revitalization of the economy is the single most important remedy for the auto industry's problems." While we fully expect the President's program to promote sustained general economic recovery later this year, the auto companies have already benefited from hundreds of millions of dollars of fresh capital infusions, directly resulting from changes to the investment tax credit mechanism enacted into law last year, as part of the President's program. The recently passed tax reform legislation will further help the economy and the auto industry by giving financial markets the assurance that Federal Government borrowing will not siphon off needed capital from the private market. The immediate result of this legislation has been a marked easing of interest rates, one of the significant factors in peoples' decisions to buy durable goods, such as automobiles.

In previous hearings on the automotive issues, one of the points on which most parties seemed to agree was that imports were no longer the immediate problem of the American auto industry. This lowered concern over imports was reinforced by the unilateral three-year export restraint on automobiles that was announced by the Government of Japan on May 1, 1981.

The Japanese restraint level for the first year, which ran from April 1, 1981 through March, 1982, (corresponding to the Japanese fiscal year), was 1,680,000 automobiles. There are separate restraints of 70,000 units on exports to the Commonwealth of Puerto Rico, which lies within the customs area of the United States, and of 82,500 units on certain station wagons and van-type vehicles which are classified as commercial vehicles in Japan but considered passenger cars in the United States. In March of this year, the Japanese Government announced that these restraints would be continued through March 1983, at the same levels as the previous year.

The Japanese Government has characterized this restraint program as a temporary and exceptional measure to assist our auto industry through a difficult time. The Administration welcomed these restraints, which rolled back the number of cars the Japanese companies were selling in the U.S. by about 7 percent. This assures that virtually every additional car that is sold in the United States during the period of these restraints will be manufactured in North America. I particularly believe that the Japanese voluntary action is effectively meeting the import problem without permanently damaging the trading system, U.S. exports and jobs as does domestic content legislation. Conversely, enactment of H.R. 5133 could lead to the immediate termination of this restraint, raising the possibility of a severe negative impact on our auto workers between now and late 1984 when H.R. 5133 would go into effect.

Let me now turn specifically to the international trade consequences of this proposed legislation. Let there be no mistake; the new version of H.R. 5133 would be directly contrary to the requirements of Articles III and XI of the General Agreement on Tariffs and Trade, which provide for national treatment under domestic laws and prohibit quantitative restrictions, respectively. GATT Article III states quite simply that no contracting party to the GATT "shall establish or maintain any internal quantitative regulation . . . which requires directly or indirectly that any specified amount or proportion of any product . . . must be supplied from domestic sources." Other sections of this same article provide that imports from another party shall be accorded treatment no less favorable than that accorded to domestic products, and that internal and quantitative regulations requiring specified amounts or proportions shall not be applied so as to afford protection to domestic production. Similar national treatment provisions are also included in commercial treaties between the United States and many of its major trading partners. Likewise, the quota used to enforce the domestic content restrictions in H.R. 5133 would violate the prohibition of Article XI of GATT against "restrictions or taxes or other charges . . . on the importation of any product" of another contracting party.

Should our foreign trading partners respond to the illegal U.S. trade actions mandated by this bill by retaliating against our leading exports such as computers, aircraft, semiconductors, and agricultural products, the cost to the employment and economic well-being in our economy is considerable. Approximately one in every seven jobs of our manufacturing sector is dependent, directly or indirectly, on exports, and approximately one in every three acres of farm land in the United States is farmed for the export market.

Proponents of this bill argue that the new version would effectively exclude all countries except Japan and Canada from the immediate effects of local content legislation. They argue further, that Japan, because of its large trade surplus with the United States and the importance of the U.S. auto market to Japan, would comply with the local content regulations and not retaliate. Even if this were so, the negative precedent set by the United States, the world's strongest economy, in blatantly violating its international commitments will lead to the emulation of our actions by other major trading countries. These countries could pass local content legislation of their own on autos, or on any manufactured products in which they were dissatisfied with the import market share. While a number of countries already maintain performance requirements in the automotive and other sectors, these are almost exclusively developing countries and do so to their own economic detriment. The net result of protectionist policies for developed and developing countries alike is lower outputs, fewer jobs and ultimately economic stagnation. I do not believe that this Committee needs to be reminded that most scholars attribute the Great Depression to similar wrong-headed policies pursued in the 1920's and 1930's.

No one can predict Japan's precise reaction to enactment of this legislation. Japan is the largest market for U.S. agricultural exports and, even without formal retaliation, could direct many of its purchases to other world suppliers. Certainly, further U.S. efforts to seek substantially equivalent access to Japanese markets would be futile after the enactment of such legislation. Furthermore, the political consequences between the United States and its closest ally in the Pacific would be extremely grave.

With reference to Canada, our largest trading partner, the new version of H.R. 5133 would subject automotive exports from Canada to the same domestic content requirements as those from other countries. This would be both contrary to the rules of GATT and the United States-Canadian Automotive Products Agreement.

In 1965, the Governments of Canada and the United States entered into an agreement to accord duty-free treatment to imports of motor vehicles and original equipment parts from each other. The major objectives of this agreement were to create an open and integrated automotive market and rationalize production between the two countries on an economic basis "in which market forces may operate." Under Article I of this agreement each government undertook to avoid actions that could "frustrate" the achievement of these objectives, and therefore jeopardize the auto agreement.

H.R. 5133 would be an incentive for U.S. producers to maximize net exports of automotive products to Canada in order to meet more easily the mandated domestic content ratio. In the past the Canadian Government has indicated its displeasure at the continued bilateral deficit in trade that Canada has had under the auto trade pact, and its desire to achieve a fairer balance of bilateral trade. In 1981, the U.S. automotive trade surplus was $1.5 billion. The cumulative U.S. surplus since 1976 was over $8 billion. If H.R. 5133 were enacted, it could be reasonably anticipated that the Canadian Government would respond with mirror-image legislation, or other retaliation, designed to achieve both its goal of balanced trade and of neutralizing the export incentives contained in H.R. 5133. If this came about, it would mean a transfer of jobs from the United States to Canada and a further drag on efficiency of production in the North American market.

On the other hand, let me make it quiter clear that we believe trade is a two-way street. If the United States is going to keep its markets open, if this Administration and Congress are to accept the political bruises of doing what is in the national economic interest, by fighting protectionism, then we can expect nothing less from our major trading partners.

With respect to Japan, the concerted efforts of the United States can no longer be measured just in verbiage, but must achieve concrete results. The Japanese market is more open today than it was five or ten years ago. However, they have not gone far enough, fast enough. In areas such as tobacco products and telephone equipment, where Japanese Government entities themselves directly control purchases, we want nothing less than dramatic liberalizing actions. It is time to reduce sharply the high tobacco products tariffs concurrently with the other previously announced Japanese tariff reductions. It is time to seriously consider the purchase of foreign made telephone equipment. In agricultural trade, where the Japanese Government has long maintained quotas on products in which we are extremely competitive, it is also time to begin dismantling these barriers.

With respect to Canada, we have formally challenged the domestic sourcing requirements promulgated by the Canadian Foreign Investment Review Agency (FIRA). Believing that the Canadians are not fulfulling their GATT obligations, we have submitted this case to a GATT panel. We feel that we have a solid case, and that a favorable decision will strengthen our hand in dealing with performance requirements elsewhere in the world. In the GATT Ministerial in November, we hope to launch a serious work program on the trade implications of investment requirements with the ultimate aim of checking the use of local content and export requirements, multilaterally.

In conclusion, H.R. 5133 is another manifestation of an affliction that Americans want left behind—the easy answer. They are tired of "quick solutions," that invariably become non-solutions resulting from a simplistic analysis of problems. Increased import share is not the problem, but rather a symptom of a decline in U.S. international competitiveness. The answer to this real problem is that management, labor, and the Government must take those actions, separately and together, that improve productivity, that reduce costs, that encourage economic investment, and that put us on a level playing field with respect to our major trading partners.

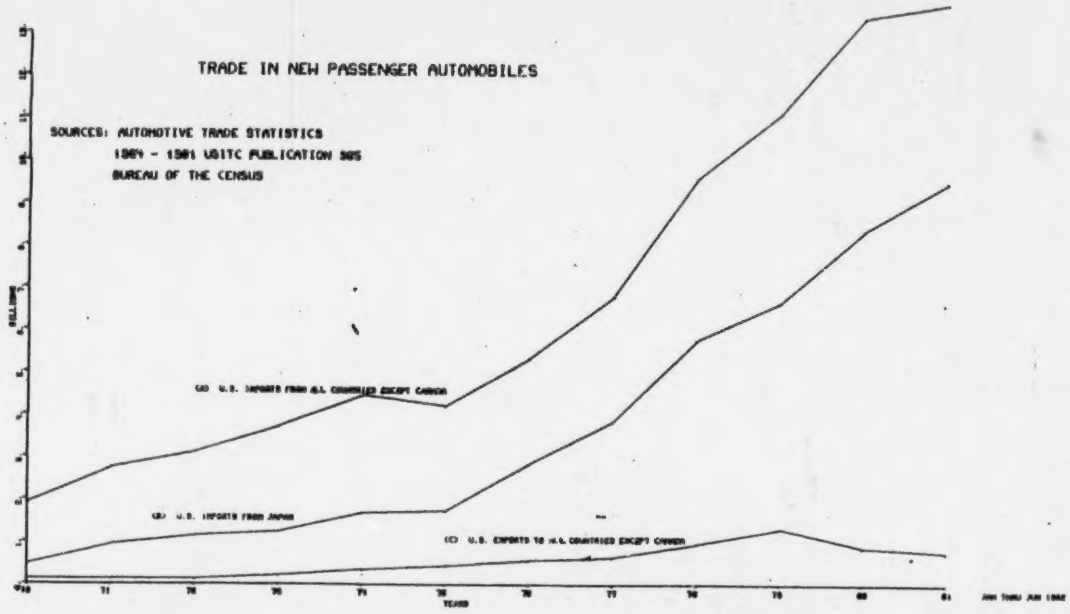
In contrast, the passage of H.R. 5133 creates new problems. It would be viewed as both a renunciation of reciprocal trade liberalization policy, currently being pursued by this Administration, and a revocation of free trade policy that has been supported by all Administrations and Congresses for over 30 years. If Congress proceeds with this legislation, our efforts to launch initiatives at the November GATT Ministerial meeting in Geneva, particularly in services, high technology and agriculture, aimed at opening and improving the trading system to the benefit of this and all nations, are bound to be met with failure.

H.R. 5133, should it become law, would cost us jobs, sales, markets, and real economic growth. This legislation will also be an engine of inflation as auto price increases alone will help meet the government mandated production ratios, since fattening profit margins count toward meeting minimum domestic content values, whether or not one more U.S. job is created.

I believe a paper published by the Labor Industry Coalition for International Trade (LICIT), a group of industrial unions and corporations, best describes why one should oppose domestic content laws and other performance requirements. I quote:

"Performance requirements are a matter of great concern because of their serious negative economic effects. . . . the international shifts in investment, employment, production, and trade which they cause are not a response to market forces. Rather, they are the result of government fiat. Their purpose is to increase the economic welfare of the country imposing such measures directly at the expense of other countries—a new form of beggar-thy-neighbor policy. . . . Such government-directed economic decisions not only injure other countries, they also result in the misallocation of resources internationally, with predictably adverse consequences for efficiency, inflation, and employment."

I urge this Committee to recommend defeat of this measure to the full House of Representatives.

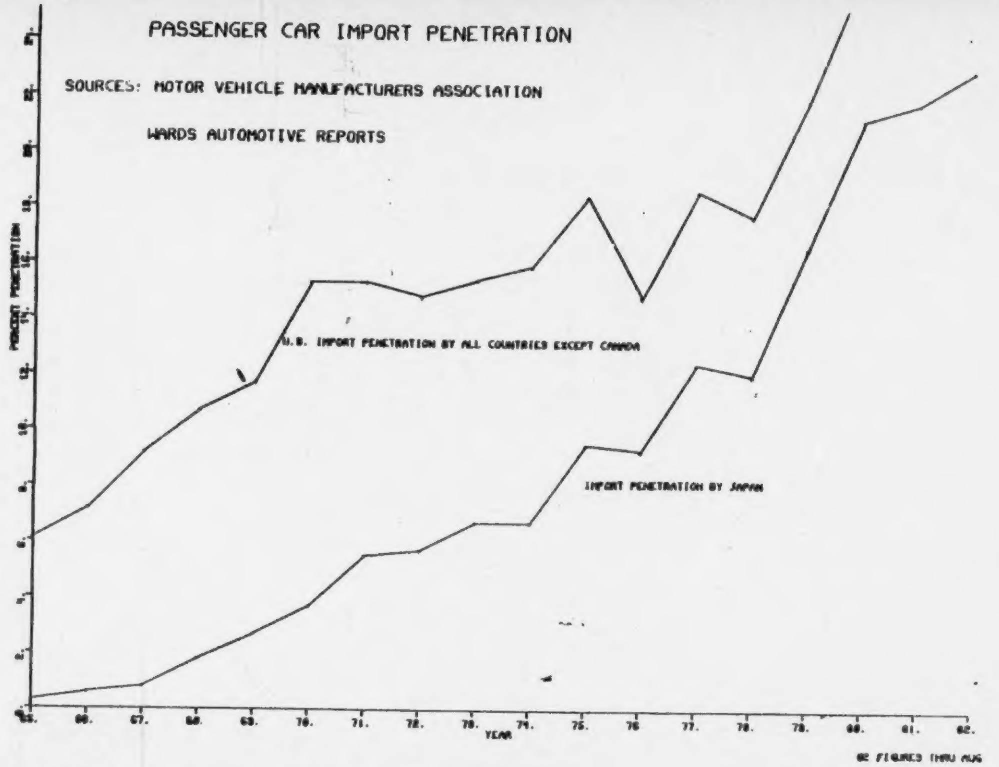


TRADE IN NEW PASSENGER AUTOMOBILES

SOURCES: AUTOMOTIVE TRADE STATISTICS
1964 - 1981 USITC PUBLICATION 305
BUREAU OF THE CENSUS

	70	71	72	73	74	75	76	77	78	79	80	81	JAN THRU JUN 1982
(A)	1.518	2.787	3.111	3.716	4.454	4.138	5.027	6.791	9.589	11.193	13.036	13.725	7.622
(B)	.456	.383	1.180	1.244	1.686	1.742	2.855	3.860	5.771	6.665	8.062	9.430	4.033
(C)	.115	.124	.123	.215	.347	.485	.567	.641	.858	1.028	.804	.766	.278
TRADE BALANCE	-1.755	-2.613	-2.330	-3.501	-4.108	-3.769	-4.760	-6.151	-8.627	-9.012	-12.512	-12.959	-7.849

USTR COMPUTER GROUP



PASSENGER CAR IMPORT PENETRATION

SOURCES: MOTOR VEHICLE MANUFACTURERS ASSOCIATION

WARDS AUTOMOTIVE REPORTS

82 FIGURES THRU AUG

DOMESTIC AND IMPORTED PASSENGER CAR SALES (IN THOUSANDS)

DOMESTIC	8,763	8,377	7,557	8,625	8,464	7,119	8,681	9,327	9,676	7,454	7,053	8,611	9,109	9,312	8,320	6,578	6,206	4,274
IMPORTED	569	651	780	1,031	1,118	1,286	1,568	1,623	1,763	1,413	1,587	1,500	2,076	2,000	2,330	2,402	2,327	1,601
JAPAN IMP.	25	56	70	170	260	313	566	623	751	537	817	918	1,387	1,356	1,770	1,900	1,856	1,214
TOTAL	9,332	9,028	8,337	9,656	9,583	8,405	10,250	10,950	11,439	8,867	8,640	10,111	11,185	11,312	10,650	8,980	8,533	5,875

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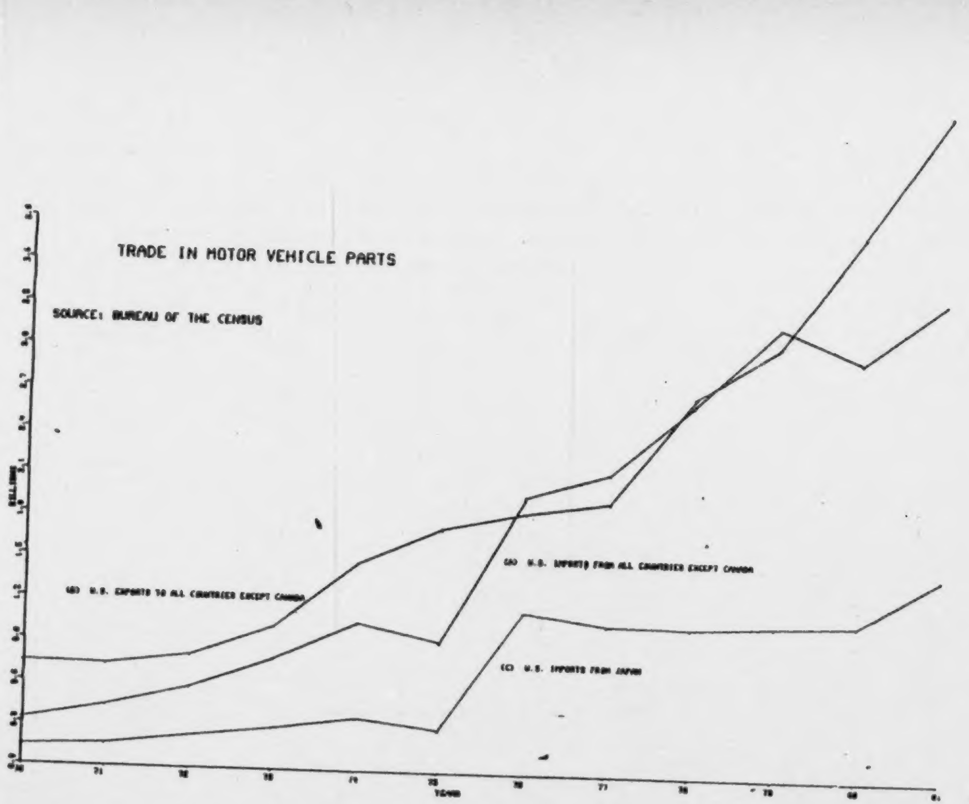
A-3



	70	71	72	73	74	75	76	77	78	79	80	81	JAN THRU JUN 1982
(A)	.328	.481	.570	.784	1.050	.922	1.987	2.148	2.659	3.210	2.900	3.417	1.664
(B)	.731	.722	.787	1.014	1.472	1.792	1.852	1.939	2.782	3.076	3.001	4.752	2.922
(C)	.185	.156	.225	.250	.371	.300	1.146	1.066	1.060	1.086	1.109	1.445	.759
TRADE BALANCE	+.400	+.251	+.227	+.250	+.422	+.010	-.115	-.207	+.049	-.184	+.301	+1.335	+.650

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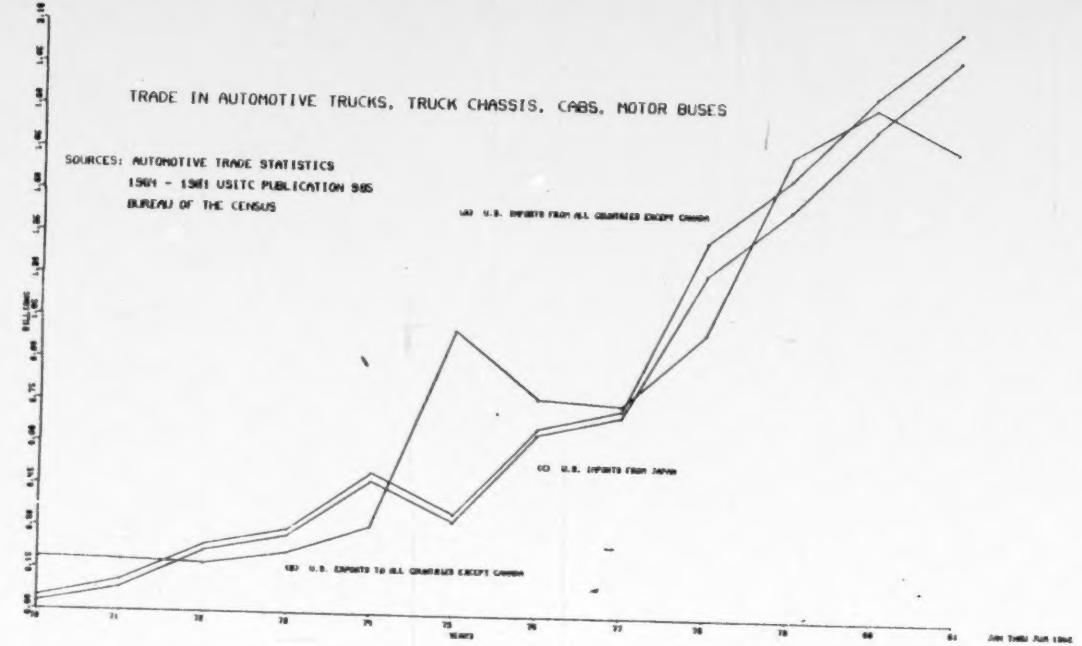

TRADE IN AUTOMOTIVE TRUCKS, TRUCK CHASSIS, CABS, MOTOR BUSES

SOURCES: AUTOMOTIVE TRADE STATISTICS
1964 - 1981 USITC PUBLICATION 985
BUREAU OF THE CENSUS

	70	71	72	73	74	75	76	77	78	79	80	81	JAN THRU JUN 1982
(A)	.047	.109	.240	.257	.503	.360	.665	.797	1.341	1.571	1.868	2.182	1.118
(B)	.100	.101	.171	.214	.312	1.012	.772	.759	1.019	1.649	1.826	1.640	.709
(C)	.027	.083	.217	.274	.472	.831	.647	.712	1.224	1.450	1.750	2.009	1.012
TRADE BALANCE	+.141	+.072	-.065	-.085	-.151	+.652	+.109	+.016	-.328	+.078	-.042	-.462	-.401

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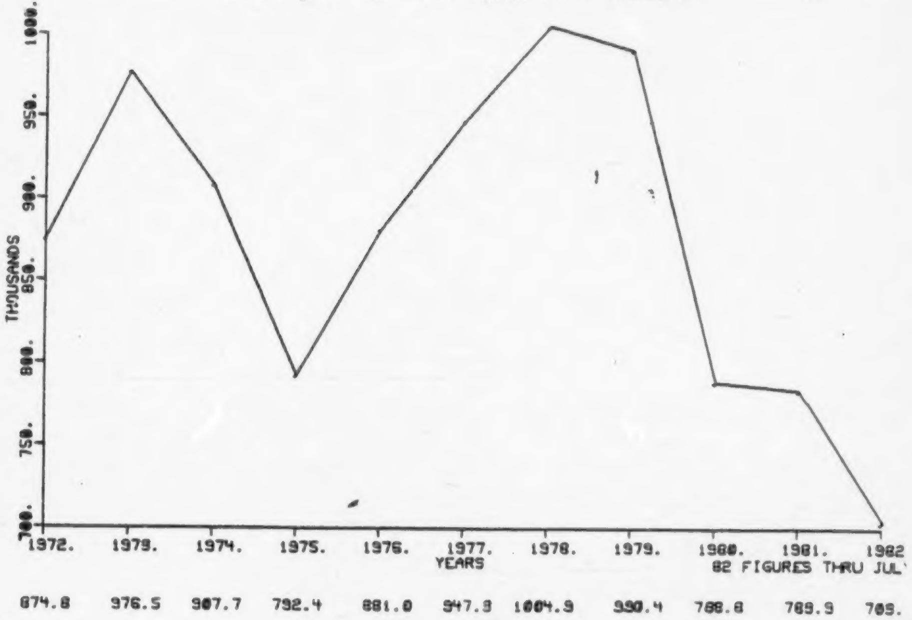
EMPLOYMENT

MOTOR VEHICLES AND EQUIPMENT INDUSTRY



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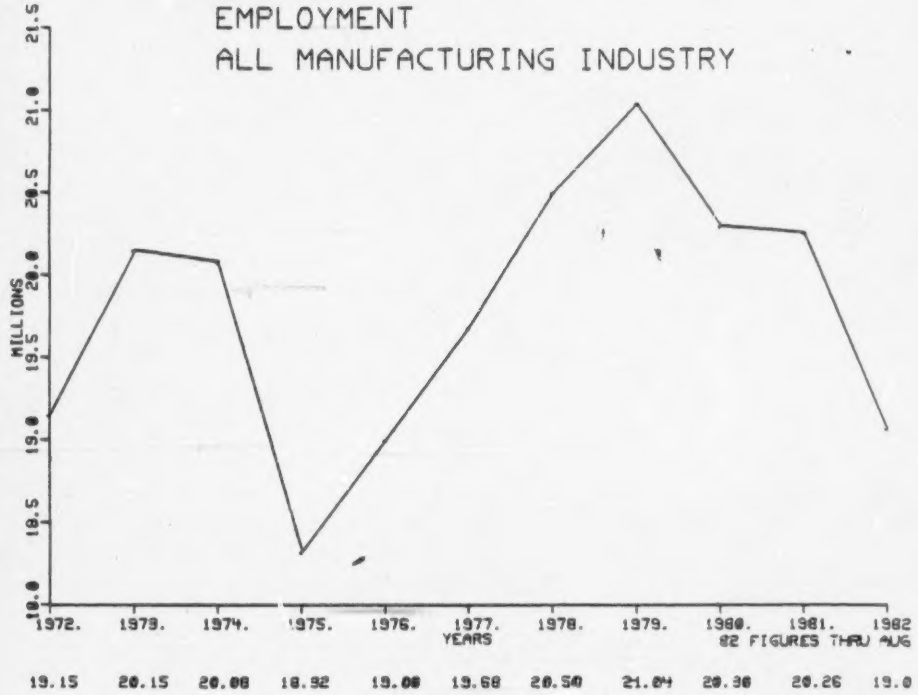

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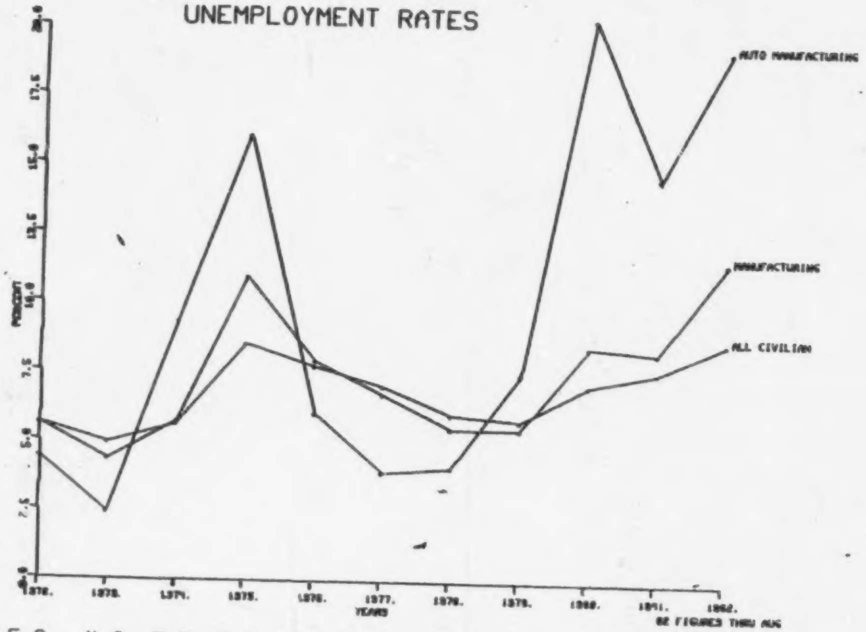

UNEMPLOYMENT RATES

ALL CIVILIAN	5.6	4.9	5.6	8.5	7.7	7.0	6.0	5.8	7.1	7.6	8.7
MANUFACTURING	5.6	4.3	5.7	10.9	7.9	6.7	5.5	5.5	8.5	8.3	11.6
AUTO MANUFACTURING	4.4	2.4	9.3	16.0	6.0	3.9	4.1	7.5	20.3	14.6	19.2

USTR COMPUTER GROUP

U.S.-Canadian Automotive Products Trade
(Millions of U.S. $)

Year	Total U.S. Exports	Total U.S. Imports	Total Trade Balance
1966	1,375	819	+556
67	1,889	1,406	+483
68	2,634	2,274	+360
69	3,144	3,061	+83
70	2,936	3,132	-196
71	3,803	4,000	-197
72	4,496	4,595	-99
73	5,726	5,301	+426
74	6,777	5,544	+1,233
75	7,643	5,801	+1,842
76	9,005	7,989	+1,016
77	10,290	9,267	+1,023
78	10,964	10,492	+472
79	12,273	9,715	+2,558
80	10,552	8,779	+1,773
81	12,055	10,618	+1,437

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U.S.-Canadian Automotive Products Trade
(Millions of U.S. $)

	U.S. Exports	U.S. Imports
Cars		
1970	631	1,474
71	985	1,924
72	1,075	2,065
73	1,439	2,272
74	1,657	2,595
75	2,142	2,809
76	2,354	3,477
77	2,655	3,795
78	2,613	4,129
79	3,147	3,707
80	2,906	3,802
81	3,095	4,295
Trucks		
1970	263	564
71	334	587
72	504	713
73	643	789
74	916	887
75	922	917
76	985	1,363
77	1,057	1,841
78	1,158	2,036
79	1,654	1,978
80	1,044	1,893
81	1,122	2,622
Parts		
1970	2,042	1,094
71	2,434	1,489
72	2,917	1,817
73	3,644	2,240
74	4,203	2,062
75	4,579	2,075
76	5,666	3,149
77	6,578	3,631
78	7,193	4,327
79	7,344	3,831
80	6,478	2,888
81	7,838	3,701

Chairman **Gibbons**. Secretary Baldrige.

STATEMENT OF HON. MALCOLM BALDRIGE, SECRETARY OF COMMERCE

Secretary **Baldrige**. I appreciate the opportunity to testify on H.R. 5133. I have got what my staff and I guess is known in Congress as a support statement and I would like to submit a longer one.

Chairman **Gibbons**. All the statements will be placed in the record.

Secretary **Baldrige**. The Commerce Department is responsible for coordinating administration policy regarding the automotive industry. Because the bill, if enacted, would have serious trade consequences, Commerce has closely coordinated our work on the trade impacts of the bill with the USTR. The administration strongly opposes this proposal. I am in complete agreement.

The bill is protectionist. It is a job-loser overall. It is inflationary and it will insulate the automobile industry from foreign competition and make it less efficient, at a time when it needs to get more efficient. Tinkering with the mechanics of H.R. 5133 will not make it acceptable.

Mr. Chairman, support for local content seems to be based on several fallacies. The first fallacy is that it will create hundreds of thousands of jobs in the automobile industry. H.R. 5133 will not lead to significant job creation.

It could even lead to job destruction. The exclusion of some foreign autos may, if other foreign manufacturers do not take up the slack, temporarily create some additional U.S. jobs, but the employment gain would be very modest and none of these jobs would be available this year or next, and most importantly, any jobs created by H.R. 5133 would be partially offset by job losses that it would produce because we doubt that foreign auto manufacturers with U.S. plants will find it economical to produce vehicles in the United States to meet local content requirements.

This bill, by jeopardizing U.S. companies, could really result in a closing of assembly facilities that are already here. We believe that the disruption of the present U.S. distribution for Japanese cars would further reduce U.S. employment. We see Japanese manufacturers curtailing their overall level of exports here rather than making additional investments to satisfy local content rules.

The decline in import volumes would mean that many import dealers would be forced to close or cut back, with resulting job losses in that area.

Finally, we believe that U.S. port facilities which handle imported cars would suffer substantial declines in employment. The Department of Transportation has estimated that local content requirements could lead to a loss of as many as 12,000 direct jobs plus additional thousands of indirect jobs at 14 major U.S. ports.

Even more important than these direct job effects, H.R. 5133 would cause further employment losses by igniting retaliation against U.S. exports. The result would be a severe blow to American farmers and American workers in nonauto industries. One of every three farm acres and one of every seven manufacturing jobs in this country depend on exports. Lost exports means lost jobs. We estimate that for every $1 billion of U.S. exports eliminated by retaliation, 25,000 jobs could be lost.

The second fallacy is that local content will save the U.S. automobile industry.

This is not so. H.R. 5133 would harm, not help, the auto industry. Locking in U.S. manufacturers at a 90-percent level of local content will prevent them from seeking the lowest cost sources of supply. Thus, while foreign manufacturers would be free to cut costs by purchasing parts wherever supplies are least expensive, U.S. companies would be hamstrung.

The consumer will also suffer under a local content law. Imports will decline and car prices will go up. The consumer would not be able to choose among the wide variety of models, prices, and performance levels available today.

What does this mean? More expensive American cars, certainly. But also the end of the world car concept here—under which a car is built with parts purchased from the lowest cost suppliers, maximizing efficiency and lowering costs.

The third fallacy is that local content can strengthen U.S. trade policy.

In fact, local content would be a major setback for U.S. trade policy. Since the end of World War II, every administration and Congress, with bipartisan support, has pursued the goal of trade liberalization. If this bill becomes law, the Japanese and our other trading partners will have no reason to take seriously our efforts to remove trade barriers. America will have repudiated its traditional leadership on free trade by erecting a massive trade barrier for autos. And I might say that particularly since World War II free trade has helped the United States more than any other country in the world.

The Reagan administration recognizes that the American auto industry has serious economic problems and early on constructed a program to address these problems. The program combines the economic recovery with tax and regulatory relief.

We have created the Office of Automotive Industry Affairs within Commerce to coordinate the administration's auto activity. We recognize that the American autmobile industry still needs help, but we believe that the problems of the industry will not be solved by enacting trade barriers. They will be solved by providing an economic environment in which the U.S. auto companies become more productive and more competitive domestically and worldwide.

To sum up, I would like to stress the following points.

This is not a jobs creation bill. It could well become a job-losing bill. It merely shuffles the employment deck across the whole economy and would end up dealing us all fewer cars.

Second, our economy has never benefited from protectionism, and it will not benefit this time.

Third, this bill is not the way to send a message to the Japanese. We do that by continuing to press hard for trade liberalization, not by inviting trade retaliation. This bill, finally, would not assist the recovery of the U.S. auto industry. The American auto industry will improve as our overall economy recovers, as management and labor continue to strengthen the industry's international competitiveness.

As a final note, Mr. Chairman, I want to state my appreciation for your decision to convene these hearings. Until today, H.R. 5133 had received only one-half day of hearings which was held last March. The questions this legislation raise demand a thorough review by Congress. Your hearings are a first step in assuring that the consequences of local content are fully understood, and I will be happy to answer the committee's questions at the appropriate time.

Chairman GIBBONS. Thank you, Mr. Secretary.

[The prepared statement follows:]

STATEMENT OF MALCOLM BALDRIGE, SECRETARY OF COMMERCE

Mr. Chairman, I appreciate the opportunity to testify on H.R. 5133. The Commerce Department is responsible for coordinating Administration policy regarding the automotive industry. I am joined by Ambassador Brock, who will testify on the trade policy aspects of this legislation. Because the bill, if enacted, would have very serious trade consequences, Commerce has closely coordinated our work on the trade impacts of H.R. 5133 with the United States Trade Representative.

The Administration strongly opposes this proposal. The bill is protectionist, and it will insulate the auto industry from foreign competition. Tinkering with the mechanics of H.R. 5133 will not make it acceptable. Adjustments in the formula for determining the domestic content of a vehicle, in the percentage of U.S. content required, in the sanctions for violations, or in the phase-in period for the content requirements, will not diminish our opposition.

Protectionism and quotas are not the solutions to the problems of the United States auto industry. Such measures inevitably backfire, and while they may yield some short-term benefit for one sector of the economy, they adversely affect the economy as a whole.

Mr. Chairman, support for local content seems to be based on several fallacies.

EMPLOYMENT

The first fallacy is that it will create hundreds of thousands of jobs in the auto industry.

H.R. 5133 will not lead to significant job creation; it could even lead to job destruction. The interagency task force that was organized to study this issue, on which eight agencies were represented, estimates that significant local content requirements will not produce dramatic increases in auto-sector jobs. True, the exclusion of some foreign autos may, if other foreign manufacturers do not "take up the slack," temporarily create some additional demand for U.S. cars, and some new jobs. But the number of jobs created under H.R. 5133 would be very modest. None of these jobs would come on line this year or next year. Meanwhile, the adverse effects of the bill begin immediately.

Any job creation estimate must be weighed against the job losses that this bill could cause if it ever became law. We believe these direct losses could arise in three principal areas—U.S. assembly facilities of foreign auto manufacturers, the imported car dealership network, and U.S. port workers engaged in unloading imported cars.

First, we doubt that foreign auto manufacturers with U.S. plants will find it economical to produce vehicles in the United States if they are required to meet substantial local content levels. Foreign auto makers, (Volkswagen, Nissan, and Honda) have determined, without any statutory requirement to do so, that certain economies can be obtained if a portion of their cars sold in the U.S. is assembled here. This bill, by jeopardizing these economies, could result in the closure of the assembly facilities. Moreover, if H.R. 5133 were enacted, the significant increase in costs to meet higher local content levels required for even modest volume increases could render additional investments unprofitable. If the present facilities were to be closed, direct and indirect jobs lost could be 25,000 workers. In addition, an estimated 10,000 workers will not find jobs if VW's planned Sterling Heights, Michigan facility is not opened.

Obviously, those Japanese auto manufacturers without assembly plants in the United States will not relocate production to this country. Why should they build

U.S. plants to produce cars on which they would lose much of the present cost advantage that they get from building in Japan? Why should they try to compete under such conditions, when it would be to their advantage to make up their U.S. losses in the growing world market, especially given their price advantage over American cars in that market?

Second, we believe that disruption of the present U.S. distribution system for Japanese cars would further reduce U.S. employment. We see Japanese manufacturers reducing their overall level of exports and exporting only as many high priced, luxury cars as the bill would allow without making additional investments to reach higher local content levels. This decline in import volumes would force many import dealers to close or cut back, with resulting job losses.

Finally, U.S. port facilities that handle imported cars could also suffer substantial declines in employment. The Department of Transportation has estimated that local content requirements could lead to a loss of as many as 12,000 direct jobs, plus additional thousands of indirect jobs, at 14 major U.S. ports.

Even more important than these direct job effects, H.R. 5133 would cause further employment losses by igniting retaliation against U.S. exports. The result would be a severe blow to American farmers and American workers in non-auto industries. One of every three farm acres and one of every seven manufacturing jobs in this country depend on exports. Lost exports means lost jobs. We estimate that for every $1 billion of U.S. exports eliminated by retaliation, 25,000 jobs could be lost.

HELP TO AUTO INDUSTRY

The second fallacy is that local content will save the U.S. automobile industry.

This is not so. H.R. 5133 would harm, not help, the auto industry. "Locking in" U.S. manufacturers at a 90 percent level of local content will prevent them from seeking the lowest cost sources of supply. Thus, while foreign manufacturers would be free to cut costs by purchasing parts wherever supplies are best and least expensive, U.S. companies would be hamstrung.

The consumer will also suffer under a local content law. Imports will decline and car prices will go up. The consumer would not be able to choose among the wide variety of models, prices, and performance levels available today.

What does this mean? More expensive American cars, certainly. But also the end of the "world car" concept here—under which a car is built with parts purchased from the lowest cost suppliers, maximizing efficiency and lowering costs.

U.S. TRADE POLICY

The third fallacy is that local content can strengthen U.S. trade policy.

In fact, local content would be a major setback for U.S. trade policy. Since the end of World War II, every Administration and Congress, with bipartisan support, has pursued the goal of trade liberalization. If this bill becomes law, the Japanese and our other trading partners will have no reason to take seriously our efforts to remove trade barriers. America will have repudiated its traditional leadership on free trade by erecting a massive trade barrier for autos.

The damage that H.R. 5133 would do to our trade policy is equalled by its threat to U.S. exports. Local content will violate the letter and spirit of the General Agreement on Tariffs and Trade (GATT). If the United States violates the GATT, as this bill would, we will be required to reduce tariffs on an amount of goods equal to the cost of the violation. If we failed to reduce tariffs, other countries could take retaliatory measures to keep out the same volume of U.S. goods. Our protectionist step would invite more of the same by other nations. How far retaliation could go is uncertain, but enactment of this legislation will certainly put an additional strain on our trading relationships.

There are supporters of this legislation who claim it will "send a message to the Japanese" about their restrictive trade policies. Frustration with Japanese trade practices is understandable, but protectionism is not the way to achieve a lowering of trade barriers.

During the past eighteen months, this Administration has constantly sought to improve trade relations with Japan: Five cabinet officers have visited Japan to underscore the importance of an early resolution to our trade problems; Ambassador Mansfield has made it clear that continuing trade tensions threaten our overall trade relationship; and U.S. trade officials have met on a regular basis with Japanese agencies to press for dramatic changes in Japanese policies.

In response, the Japanese Government has taken three major steps: In November, the Japanese Government announced tariff reductions, in advance of the timetable agreed to in the multilateral trade negotiations, covering more than 1600 items; In

January, the Japanese Government identified 87 specific trade barriers and promised action on 63; and In May, the Japanese Government put forward a second package of market opening measures, including steps to correct monopolistic practices in the distribution system and restrictions on foreign participation in Japanese government-sponsored R&D. Prime Minister Suzuki also called for an end to all forms of public and private discrimination against imports and foreign investment.

These actions have not always been as effective as we would like. Our Government is holding monthly follow-up meetings with the Japanese Government to assess the real value of the measures to U.S. business. To date, this can be said about our progress: Some measures, such as the tariff cuts and improved customs and product testing procedures, appear promising; The various packages, however, contain no effective measure to deal with major structural barriers in the Japanese economy—including target industry programs, preferential relationships within the major Japanese industrial/financial groups, special protection for depressed industries, and import cartels; and The Prime Minister's call for an end to discrimination against foreign business has not produced results. Without a thoroughgoing change in private and public attitudes at all levels, real progress is far off.

The Cabinet Council on Commerce and Trade, which I chair, has requested the United States Trade Representative to lead an effort to develop a long-term strategy addressing our econonic relations with Japan. Our aim is to obtain an equitable standard of access to the Japanese economy and, at the same time, to provide a credible counter to Japanese policies affecting key U.S. industries—without the high cost of protectionism. Local content legislation would seriously compromise this effort.

THE U.S. AUTO INDUSTRY

Since its first days, the Reagan Administration has recognized that the American auto industry has serious economic problems. Early on, we constructed a program to address the problems. This program combines economic recovery with tax and regulatory relief. We have created the Office of Automotive Industry Affairs within Commerce to coordinate the Administration's auto activities.

The industry's problems do not result solely from imports, and cannot be solved by excluding imports. U.S. sales of imported cars increased by only 300,000 units from 1978 to 1981, while sales of domestic cars fell by 3 million units. The decline in sales of U.S. made cars, not the increase in the volume of imports, has greatly increased the market share of imports.

Many factors, not one, account for the industry's recent difficulties. First, back-to-back recessions. Second, a slow-down in the rate of growth of long-run demand for new cars. Third, international competition. The first problem will be corrected by economic recovery, which I expect to be underway in the fourth quarter. The second and third factors, by contrast, are basic challenges to the industry.

Auto demand has been affected by population changes resulting in a slower increase in the number of new drivers. It is also depressed because a smaller share of income has been available for car payments, as other auto costs (gas, insurance, and repairs) have risen. From 1978 to 1981 the overall costs of new car ownership increased by 55 percent, while the CPI increased by 39 percent and disposable personal income rose by only 33 percent. Consumers have relatively fewer dollars to spend on a product which has become increasingly expensive to purchase and operate. The result is that consumers are deferring the purchase of new cars.

Many American consumers have come to believe—rightly or wrongly—that foreign cars are better made and offer better value than domestic cars. U.S. producers know this, and have made enormous investments over the last several years to develop high quality cars that are priced competitively and operate economically. They are succeeding, but it will take time. With import protection, however, much of the incentive to make these changes will disappear.

We recognize that the American auto industry still needs help. But, we believe that the problems of the industry will not be solved by enacting trade barriers. They will be solved by providing an economic environment in which the U.S. auto companies become more productive and more competitive domestically and worldwide. The Administration has a program of economic incentives, regulatory relief, and trade liberalization aimed at achieving those goals.

To sum up, I want to stress the following points:

1. This is not a jobs creation bill; it could well become a jobs destruction bill. It merely shuffles the employment deck across the whole economy, and deals us all fewer cards.

2. Our economy has never benefitted from protectionism, and it will not benefit this time.
3. This bill is not the way to "send a message to the Japanese". We do that by continuing to press hard for trade liberalization, not by inviting trade retaliation.
4. This bill will not assist the recovery of the U.S. auto industry. The American auto industry will improve as our overall economy recovers, and as management and labor continue their efforts to strengthen the industry's international competitiveness.

As a final note, Mr. Chairman, I want to state my appreciation for your decision to convene these hearings. Until today, H.R. 5133 had received only one half-day of hearings, which were held last March. Since then, the bill has been completely rewritten. The questions which this legislation raise demand a thorough review by Congress. Your hearings are the first step in assuring that the consequences of local content are fully understood. I will be happy to answer the Committee's questions at this time.

Chairman **Gibbons**. Mr. McNamar, speaking for the Treasury Department.

STATEMENT OF R. T. McNAMAR, DEPUTY SECRETARY, DEPARTMENT OF THE TREASURY

Mr. **McNamar**. I am here today representing Secretary Regan, who is unfortunately out of town. He wanted to come because of his interest in opposing this legislation. We welcome the opportunity to present the Treasury Department's views on what we regard as the single most troubling piece of trade legislation to be considered in the last quarter century.

The proposed bill to impose local content requirements on automobile sales in the United States, although admittedly well intended when it was introduced in an effort to preserve jobs in the hard-hit automobile industry, H.R. 5133 would have profound negative implications for our own economy, international trading system and ultimately the people it would be intended to help, the average working men and women in America.

The administration strongly opposes local content legislation in any form whatsoever. In general, such legislation is a giant step away from the open market economy that would benefit us all and which was reaffirmed at the Versailles summit this summer. It would transfer income from U.S. consumers and exporters to auto workers and parts producers. It would mortgage the future of the automobile industry and prevent the adjustment necessary to have a viable automobile industry in this country. It would jeopardize jobs in the export sector, is a violation of U.S. international obligations on an unprecedented scale, threatens the unraveling of the international trading system, and could prevent a worldwide economic recovery.

Today, however, I would like to concentrate my remarks on my deep concern about the adverse implications of this legislation for the U.S. economy. I am sure that we all share the same vision of what the U.S. economy should be. It should be efficient, prosperous and able to adjust to changing economic circumstances. We must ask ourselves does this legislation contribute to this type of an economy. The answer is clearly "no."

Local content legislation is permanent protection for industries that are unable to compete for whatever reasons. The basic principle of local content is that U.S. inports must be used whether or not they are competitive.

If U.S. inputs are competitive, the legislation is unnecessary. If they are not competitive, we will be protecting and rewarding inefficiency and forcing U.S. auto consumers to pay the cost, that is, it is a hidden inflationary tax that is regressive because it falls mostly on those who must purchase cars. There would be no incentive to keep U.S. costs down. In fact, the higher U.S. costs the easier it is to meet the local content requirement, a perverse effect.

Application of this principle to the economy as a whole would do most to bring about an unproductive, inflationary, inefficient economy. It is for those reasons that the administration is opposed to the principle of local content. This administration's opposition based on principle will not be sacrificed for the short-term political gain that some would seek.

The U.S. auto industry is currently engaged in a massive effort to shake off the legacy of its previous isolation from foreign competition. It is seeking to improve productivity, to become more innovative and efficient, and to offer consumers once again the kinds of autos they demand. Local content legislation can only thwart those efforts at a cost to the rest of the economy.

Let me elaborate. Local content legislation is an especially pernicious form of protectionism. It flies in the face of adjustment to international competition. It seeks to repeal the economic laws of competitive advantage. By offering long-term protection with no incentives for efficiency, it promotes a perpetually inefficient industry that can ultimately only be protected at a cost to the rest of the economy. Ambassador Brock mentioned the Australian experience.

This is not merely a theoretical objection to local content legislation. Of the 22 OECD member countries, only Greece, Turkey, Spain, and Australia impose local content requirements. As a group, these countries are not noted for the efficiency of their automobile industries.

Indeed, the Australian experience has led to a high-cost inefficient industry which has led to calls by consumer groups for trade liberalization. Australian automobile production and employment have continued to fall despite the estimated $1 billion per year cost to Australian consumers.

Recently the stringent parts and labor requirements contained in the original bill, H.R. 5133, were modified in an effort to make local content less onerous. The result was the bill which we are considering today. This legislation broadens the concept of local content from parts and labor to include items such as taxes, advertising, overhead, and variable profits.

According to our analysis, this legislation now has the paradoxical effect of tying the hands of U.S. auto manufacturers with high levels of local content while apparently permitting numerous smaller foreign manufacturers to nip at their heels free of similar restrictions.

Because of their high volume of sales, U.S. manufacturers would have to meet local content requirements of 90 percent. In return, they would be protected from any one foreign manufacturer getting a large share of the U.S. market without meeting similar requirements. They would not, however, be protected from imports. Under the broad definition of local content, many manufacturers may be able to sell as many as 400,000 cars annually apiece without substantial increases in purchases of U.S. parts or investment in U.S. production facilities.

The impact on the U.S. auto industry would be substantial. At a time when the industry is beginning to make the necessary adjustments, this bill would preclude it from competitive worldwide sourcing, while leaving the industry vulnerable to imports from many foreign manufacturers with smaller U.S. sales which would not suffer the inefficiencies prompted by local content requirements.

I would point out that the impact of the worldwide sourcing would be particularly adverse on the Chrysler Corp., where this Congress has had a Chrysler loan guarantee program administered by the Treasury Department for some time.

The problem with this local content legislation, however, is not that it is unfair to the U.S. industry and too soft on imports. Rather, the problem is with the concept of local content itself. Adopting ineffective local content legislation now only opens the door to stricter local content requirements later, with enormous future costs.

Again, let me emphasize that although today we are discussing one form of local content bill, H.R. 5133, the administration's opposition is not limited just to this bill. There are no fixes that will make the concept of local content legislation acceptable to this administration.

There are additional costs to the economy besides the inefficiency inherent in local content legislation. Implicit in local content legislation is acceptance of the principle that it is acceptable public policy to require transfer payments from the rest of the economy to a particular sector, in this instance auto workers and parts producers. Indeed, this bill could be labeled an income redistribution bill designed to have the average American's income taxed and redistributed to automobile industry workers and managers.

I would ask the committee the question. Why not such a bill for lumber industry employees and savings and loan employees? Aren't they equally deserving?

Although difficult to estimate, U.S. consumers can expect to pay more for automobiles as a result of reduced foreign competition and a more inefficient domestic industry. U.S. exporters, generally our most efficient industries, can also expect to suffer. If other countries retaliate by restricting imports of U.S. agricultural products or export-dependent industrial goods, or if they mimic U.S. content requirement for their products, U.S. exports will pay the price of protection for the auto industry at home.

As auto exporting countries earn less income from their auto exports to the United States, their ability to purchase U.S. goods will also be diminished. Such countries may also purposefully choose to purchase non-U.S. products whenever they can as a form of retaliation. The potential risk to our exporting industries is substantial and must not be ignored—especially at a time when U.S. industries are clamoring for increased Government assistance to exports.

The nature and extent of any jobs gain in the auto industry from this legislation is questionable. There is, however, no question that the legislation itself may jeopardize jobs in other parts of the economy. It would also cost the economy in terms of higher prices for consumers and jobs lost in the import-handling sector and through the closing of imported auto dealerships.

Clearly, the burden on the rest of the economy from such legislation is too high.

The United States cannot afford the luxury of passing legislation which inevitably promotes a noncompetitive industry which would act as a drag on the entire economy. The economic law of competitive advantage will still exist. This legislation won't change it. Rather, we must adopt policies to promote industries which are competitive domestically and worldwide, which contribute to sustained non-inflationary growth. We cannot afford to foster industries which thwart these goals and must be supported at a high cost to the rest of the economy.

Indeed, the current dispute between the United States and the European Community over steel imports into the United States simply reflects the consequences of European Community policies to maintain their inefficient producers.

Once instituted, these types of protectionist policies substitute political judgments for economic realities. How would the Congress stop? How many industries can we protect this way and still claim we have a free economy?

Trade restrictions are not the answer to our fundamental economic problems. A better answer lies in the broader macroeconomic policies this administration has been pursuing to create the environment in which U.S. industries can again become healthy, vigorous and competitive. As you know, the cornerstones of this policy are:

Relief from excessive regulation; the reduction of inflation; tax measures to stimulate investment and savings; and reducing government [illegible]

These policies [illegible] designed to permit the efficiency of the market to operate, will [illegible] U.S. industries such as the auto industry to regain that [illegible] edge, and at the same time, will insure that the rest [illegible] economy and the world does not suffer the drag of indutries [illegible] avoiding the pains of adjustment because of protective legislation.

Chairman GIBBONS. Thank you, Mr. McNamar.

In order to be fair to all members, I tried to keep track of who came in and how they came in to abide by the rules.

After I question briefly, I will try to observe the 5-minute rule and I will recognize Mr. Brodhead, Mr. Bailey, Mr. Frenzel, Mr. VanderJagt, Mr. Schulze, Mr. Jenkins, and then Mr. Downey.

I want to thank each of you for the hard work that you have put in the preparation of these statements. I appreciate your coming here on rather short notice. I notice that all three of you oppose this legislation without equivocation, and have pointed out that the administration as a whole is opposed to it.

Mr. Brock, one of the things that struck me is how the bill discriminates against other American business sectors, the labor, the management, and the ownership in other American businesses.

As I look at America, we have two exceedingly sick industries. One is the steel industry and the other is the auto industry.

It may not be a causative factor, but certainly it is a characteristic of both industries that they have extremely high wages in relationship to other American industries.

The steel industry, as I recall, has a wage rate that exceeds the rest of American industry by about 70 percent. Second only to the steel industry, of course, is the auto industry, and it is not far behind.

Now, it is probably just a coincidence that these two sick industries have this kind of high wage rates and have low productivity rates.

As I recall from reading about this subject, it takes twice as many American steelworkers to produce a ton of steel as it does Japanese workers, not because the workers are any better or any worse, but because of the tools that they have in their possession. Reading the analyses done by a number of different sources points out that a Japanese car landed almost any place in the United States has a $1,800 to $2,000 cost advantage over a U.S. car.

When you get further into that analysis, the actual wage differential only breaks out to be about $600. The rest of it, the other $1,200 or $1,800, $1,200 to $1,400 is essentially better management, and better tools, and equipment.

To me, that tells me that the steel industry and auto industry are not exceptionally well managed. It looks to me that while the management of these two industries have been relatively quiet in this, that they have been able to enlist the help of their labor unions to come in here and lobby for the tremendous advantage they have over other American workers, while the management sits back and sort of rides along like a crocodile about to swallow a rabbit in all of this.

I come to the conclusion that what we really have before us is a piece of economic aggression by a cartel that comprises the labor unions and the management of the auto industry trying to take economic advantage of every other American business and job. I see that your statement, to some extent, implies that, perhaps a little more diplomatically than I put it. Would you mind elaborating a little on that?

You gave some very important figures about the jobs that have been created outside of these industries in the last few years.

Ambassador **Brock**. I would be delighted to, Mr. Chairman. First of all, as I said in my remarks, four out of five of the new manufacturing jobs in this country were created in the export industries of the United States.

Those are very competitive industries. They compete worldwide, and they have been able, through management and labor cooperation, to market their products competitively around the world.

They have had the highest rate of growth.

If you compare the job creation potential of our companies that are involved in exports compared with those who are internally focused, the rate of employment in the 1970's in this economy grew four times faster among companies that were trading internationally than it did among those companies that were not.

I think that says a couple of things. First, that they were competitive, but, second, that there is a huge and growing opportunity for

American job creation if we remain internationally competitive and involved in the marketplace.

The concern that I have with this particular bill is that if we, as the leader of the world, and there is no other, if we take a practice of this kind and enshrine it in law, every other country will follow suit, and you run the risk of a collapse of world trade.

We do $450 billion worth of business in this world. Five plus million workers.

Chairman GIBBONS. How much?

Ambassador BROCK. $450 billion. Better than 5 million workers are directly, directly involved in export of jobs. Those jobs are at jeopardy if, in fact, we turn our back on the liberalization of the world trading system.

There is no human way, no way, that this country can continue to lead the cause of liberalization in opening up other markets, if we close our own.

That is precisely the threat of this bill in international trading terms.

Let me bring it down, then, a little bit closer to home in terms of the discrimination among industries that you have referenced.

The estimate that we have made is that this bill will increase the price that every American consumer pays for every car by a minimum of $1,000. My own estimate is that it might reach $1,500, but the Commerce study says $1,000 per car.

If you assume that we only sell 5 million cars in a year, whether they are imported or domestic, that is an increased charge on the American consumer of $5 billion.

Mr. Chairman, if the Congress wants to help a particular industry, let's do it straight out. Why don't you just pass a bill appropriating $5 billion for the domestic industry?

It would then be equally spread across all American taxpayers, and not just attacking automobile buyers.

Second, it would not discriminate against workers in other fields by depriving them of their jobs. I personally would not think that is a wise way to go, but it is a wiser way to go than this bill, which has such inherently dangerous complicating factors involved in it that it could destroy major market opportunities in which Americans are presently gainfully employed.

Chairman GIBBONS. What other product sectors are liable to be affected by this legislation, if it becomes law?

Ambassador BROCK. All farmers, because a third of our cropland is planted for export, chemical workers, pharmaceuticals, computer workers, electronics, electrical, aircraft, banking, insurance, engineering, data transmission, moviemakers, advertising agencies, all of those could be at risk with this kind of legislation, and a lot more.

Chairman GIBBONS. Certain foreign manufacturers have recently started establishing manufacturing subsidiaries or assembly branches in this country. What impact would this legislation have upon them?

Ambassador BROCK. The Honda plant presently under construction in Marysville, Ohio, will employ 2,000 workers and be open this fall. They cannot comply.

The Nissan plant in Tennessee, is a $300 million development scheduled to open approximately in the fall of 1983, could not comply.

There are a number of other companies that—well, frankly, I am not sure that American companies can comply, but that is debatable. Those two clearly would be in a very hazardous position.

Volkswagen, I assume, Renault, both produce in this country as well, and I think would be also at risk.

Chairman GIBBONS. Is there any way this bill would encourage any new foreign investment?

Ambassador BROCK. That is one of the principal claims of the proponents of the legislation, Mr. Chairman. I don't agree. My own personal instincts would argue that this will cause such a terribly damaging impact on world trade that there will be a substantial reduction in world trade, and that means a substantial reduction in investment.

I think it might retard investment in this country, rather than encouraging it. I think the end product might be a substantial loss of investment and jobs.

Chairman GIBBONS. We have had in existence for a number of years a United States-Canadian auto agreement reached voluntarily by the two nations.

I meet about once a year with the members of the Canadian Parliament. Ever since we have been meeting, I have heard them complaining about how unfair this agreement is. Yet they continue to live by it although they don't feel like they get the best advantage out of that agreement.

What would this legislation do to that agreement?

Ambassador BROCK. I don't see how the agreement could survive, Mr. Chairman. I think what would happen is the bill would mandate U.S. manufacturers to comply with it themselves to increase the level of exports regardless of the agreement to Canada, Canada is a much smaller economy than our own.

They have one-tenth of the population that the United States does. They would have almost no recourse other than to defend themselves against that practice, and provide some form of mirror responsibility.

If they did so, it would shut off the U.S. exports. It would reduce jobs in the United States, and substantially impair the efficiency of manufacturers in both Canada and the United States, thereby reducing the competitive circumstances of our own automobile companies as it damaged our most important trading partner.

Secretary BALDRIGE. Mr. Chairman, may I comment on the Canadian?

Chairman GIBBONS. Yes.

Secretary BALDRIGE. Last night, the Canadian Embassy contacted our Office of Automotive Industry Affairs and delivered the following verbal statement:

> We are concerned about H.R. 5133. Canada opposes local content in principle and finds the bill particularly unacceptable in that it ignores the U.S.-Canadian Auto Pact. We assume that the Administration will not contenance the application of content requirements to Canada in keeping with its obligations under the Automotive Pact.

We have had a lot of benefits from that pact. It is an attempt toward integration of the two automotive economies, but the fact is since 1965, the United States has had a $13 billion surplus under that, because of sales in the after market and so forth, and this would truly be going the wrong way in that situation.

Chairman **Gibbons**. I have a great many more questions for you, gentlemen, but I will try to abide by the rules.

Mr. Brodhead.

Mr. **Brodhead**. Thank you, Mr. Chairman.

Mr. Ambassador, we have discussed this problem, you and I, before, formally and informally, on and off the record.

I think there are some points that need to be made that were not made in the testimony, in your testimony, and in the testimony of other witnesses that are before us today.

First of all, I think you paint with a rather broad brush, Mr. Ambassador, when you talk about the fact that you contend that this would be a worldwide disaster.

The basic fact of the matter is that this legislation really impacts only one country, and that is Japan. As the legislation has been redrawn, it would restrict imports basically only from Japan.

Now, there is a problem with Canada which we have referred to here. We have an ongoing problem with them in a number of areas, as you well know, but the basic impact of this thing, of course, would be on Japan.

It would not affect our European allies and trading partners. Their imports would not be covered by the legislation.

In that connection, I think it is important to point out that we have tried in a number of ways to emulate the Japanese industry, emulate the kind of efficiencies that they have brought about in their trading system, and I think it is important to point out that they built their auto industry, as well as a number of their other industries, behind the protectionist wall. That is how they built up their auto industry.

They did not allow foreign investment in their industry. They did not allow imports, and as you know, even though there is probably only a relatively small market in Japan for American automobiles, there are a vast range of nontariff barriers to American automobile sales in Japan that exist today, and I am told by constituents who are in the automobile parts and supply business that they have a tremendous amount of difficulty in exporting to Japan, so that at least if the contention of the administration is that this strategy won't be successful, at least there is the Japanese example to argue, not only in the auto industry, but in a number of other industries that it can, indeed, be a very successful strategy. It certainly has worked for them.

Another point is that one would have the impression, I think, from the testimony of the administration, that this legislation were some sort of a new departure, that we would be going into policy areas that we have not been in before, when the fact of the matter is that we have a large number of barriers of imports into this country, a large number of industries that we have—decided, the Congress and a number of administrations have decided—that it is in the interest of our Nation to try to extend some protection to.

Of course textiles, footwear, a broad range of agricultural products, it seems like three or four times a year on the House floor, we are voting on one form or another of protectionism for American agriculture, the chemical industry, trucks, and so on, and on and on.

It is a very long list of various kinds of protection that we already have, so we are not really talking here about losing our virtue if virtue we had in the free trade area.

We have lost it now. We are really just talking about the price, not about the status of our virtue.

Another point, I think, of course, that is continually raised with respect to this legislation, and it was raised today, is the question of the GATT, and what the impact is going to be on the GATT.

I think the GATT is something that we all, at least in theory, believe in and have hopes for, that it will bring about freer trade, that it will bring about a more open economic system.

The fact of the matter, I guess, is that clearly the GATT hasn't worked in the sense that there are a large number of barriers that other countries have to American exports.

You alluded to a number of those points in your very forthright testimony, and in previous testimony, about the problems that we are having with Japan. We have complaints, as you are all too painfully aware, from a broad range of American industry about trade barriers that our Japanese friends have erected against American exports.

In addition to that, of course, there is the fact that there are a large number of GATT members, GATT signatories, GATT participants, who have some very extensive and effective limitation on the importation of foreign automobiles.

Secretary McNamar alluded to Australia, but in addition to Australia, there is Belgium, Brazil, Canada, France, Germany, Italy, Japan itself, Spain, and the United Kingdom. These are all GATT members.

All have substantial limitations on the imports of Japanese automobiles into their country, so that if GATT were going to be important, if GATT were going to be effective, then one would think that these issues would have been addressed and successfully addressed long before now, since these limitations of one sort or another have been on the books for a great period of time in many cases.

I think these are some additional items that need to be pointed out. I could not agree more with the basic thrust of the testimony of all three administration witnesses, that is the effect that improvements in the American economy, reduction of interest rates and so on, would probably do more than anything else to help the American industry, but in the absence of that, and in the likely event that things are not going to get any better, it seems to me that we have to try to address the very serious problems in this industry, the slow destruction, really, of one of our most basic and our most vital industries, and take into effect the fact that we are losing capacity, production capacity that historically was extremely important to us.

Without the production capacity in this auto industry, anyone would have to agree that World War II would have gone on a lot longer than it did, but we are suffering a permanent loss in production capacity. We have several hundred thousand people directly or indirectly out of work as a result of the problems in the auto industry.

We have not had really very much cooperation to date from our Japanese friends and trading partners in terms of trying to do something about the problem and limit the barriers to trade.

There has been a lot of lip service to that goal on both sides. In view of the fact that nothing has been done, in view of the fact that we protect other industries, and in view of the fact that other countries have the same kind of thing, it seems to me that it is something that is not out of line for us, and something that we really ought to very seriously consider.

Ambassador **Brock**. I understand the sentiments. A couple of points.

The gentleman from Georgia knows full well that the textile industry, which was referenced by the gentleman from Michigan, is also suffering. Even though we have very strict quotas, very strict tariffs on imports in that industry, but the unemployment level in the textile and apparel industry is almost double the national average, and not far from the present circumstances of the automobile industry, so I think it is fair to ask if, in fact, protection really is the answer.

You talk about other countries, Congressman. That is like saying because there is an arsonist in town, we all ought to go out and set fires. That does not make sense. We would live in a horrible world if we tried to do that.

Of course, I referenced the international hazard because that is my job and I have to be concerned with it. We have got a ministerial meeting with the GATT to deal just exactly with this kind of problem. If we can do a decent job of leading the world, just maybe we could get a commitment from those ministers in November to stop the proliferation of these practices around the world.

I can't guarantee it, but there is at least a good deal of interest in the Australian procedure for a cease-fire, and if we could sell that concept, it would be a tremendous step forward.

We certainly cannot do that if we take a step backward. You say that this affects only Japan. Let me suggest to you that our five principal trading partners in the world are Japan, Canada, Mexico, or four trading partners, I guess it would be, and Europe.

You are correct that the level of imports from most European manufacturers is not sufficient to reach the trigger, but it is not correct to say that Japan is the only one affected. Canada and Mexico will clearly be negatively impacted.

Take Mexico as the perfect example. That country is in desperate, really desperate circumstances. We as a government are trying very hard to do everything we can to help them right now, because of the collapse of their economy, the collapse of their peso.

This law would just about eliminate the investments that have been made in Mexico in all the automobile parts and production and would make it, if not impossible, enormously difficult to see an end to the dark tunnel that they now inhabit.

Last, I really must disagree with you on whether or not the GATT has worked. I have been sufficiently critical of the GATT for the 19-plus months that I have been in this job not to try to say it is perfect. You know better.

I do, too, but I wonder if anybody seriously believes we could have gone from $40 billion worth of trade to $460 billion worth of trade in the last two decades, had there not been an international industry with rules, with dispute settlement mechanisms which allowed for the liberalization of world trade, for the expansion of trading markets, and for the fact that in the last decade alone U.S. exports have gone from about 4 percent of GNP to 9 percent. Twenty percent of our manufactured product goes for export, one-third of all the wheat produced on the farm goes for export.

I personally think that the GATT has worked remarkably well, and if you look at the stress of the international trading system since the Arab oil embargo and the doubling and doubling and doubling again of energy prices in the last 8 years, I think it is a remarkable testament that it has survived under the pressures of the last decade. So with all of its warts, and we have our own, the GATT has been better for us than the alternative of no system at all, so it is imperative that we try to take what we have as a good starting point, and work to improve it. This bill, in my judgment, would result in the complete failure of any such effort.

Mr. BRODHEAD. Just one point. You mentioned members and the adverse impact that this would have on them. As you, I know, are all to painfully aware, the Mexican Government has far more stringent legislation, much, much more stringent legislation than we are talking about here with respect to the content of automobile products, and as a result of that legislation, as a direct result of that legislation, there have been a large number of jobs lost in Detroit.

Engine plants have gone to Mexico because there is an absolute requirement that the Mexicans have that the dollar amount of imports and exports of automotive products have to be approximately equal, so an appeal that this legislation may harm our relations with Mexico or may harm Mexico, I think probably is going to fall on deaf ears with a lot of people.

They seem to have gone far beyond anything that we are talking about here, in terms of trying to pirate American jobs, and despite that, they have not been very successful.

Ambassador BROCK. I am not defending Mexican practice. I think some of the economic policies that they have adopted are part and parcel of the economic difficulty they now have.

I wonder if you really suggset that we should follow the same rule, because that is what this bill does.

Mr. BRODHEAD. I guess I would disagree with you, sir, that it does. I think it is far less stringent, far more reasonable legislation than what they have.

Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you very much, Mr. Chairman.

You know, I had very much expected a different response, particularly from you, Mr. Ambassador, for whom I have a great deal of respect, intellectually and personally.

What are we doing to respond to the root causes of the problem that we have? Are we equalizing our tax laws to make capital costs competitive with other industrialized nations?

Certainly you could not defend a hypothesis like that in light of the recent tax bill, could we?

Could we talk about what we did with accelerated depreciation? Can we talk about our approach to an investment tax credit? Can we talk about the attitude of not just this administration, but others in a preoccupation with short-term high-profit turnarounds as opposed to long-term capital-intensive investments?

Because we have not had Government policies to respond to those things—preferential treatment—are we going to kid everyone?

The reason those industries are so highly capitalized and so competitive overseas is because they have had the advantage of having investment. We have jawboned our steel industry to death in this country.

Talk about the export or transfer of technologies and of capital, and then seriously sit down and discuss what American trade policy has been in the last 30 years, and then turn around and try to blame that on American industry and American management and American labor?

That is absurd. It is patently absurd, and everyone in this room knows it.

I have never heard any serious student of the American steel industry's problems offer that those high-labor costs—and I have worked in the steel industry, I have worked in the mills—that they have ever tried to prevent capital investment in the industry. They have done a lot of innovative things, and that is what I was hoping to hear from you people, but we have not done that.

Those industries overseas have been built on the basis of preferential treatment, market barriers from other countries. That is why they exist where they are. Look at the military implications.

What are you going to do in this country without a vehicle industry? Where are you going to draw the line?

You want to talk about implications, let's talk about them.

Mr. Ambassador, can you tell me why every single capital-intensive industry in the United States of America, bar none, the major intensive capital-intensive industries in the United States of America, with the exception of high-technology services, are all in such serious trouble?

I think there are a lot of good explanations for that, and it is not because unions are bad, and it is not because people are paid too high. They have bled and worked and fought for this standard of living, and they do have a right to protect it.

They certainly have a right to protect it when some ideologic or philosophical goal to which we all aspire is somehow being treated differently in some foreign land and we cannot cope with it.

We all know how rough and tough some things are, but we all know that some of the root causes of the difficulties in America go further than saying that the automobile industry is in here seeking preferential treatment.

That is simplistic. We can discuss a number of items on budget and tax issues.

I can give you some good examples of preferential treatment. The truth is that this society, and it is not just this administration, it is not just you, we have given up or failed to come up with creative solutions to the difficulties that many of our basic industries face.

The problem is that those ideals of free enterprise and those goals of free trade do not coincide with military and economic and diplomatic realities around the globe, so we have got to compromise those two things.

Now, this bill is not, in my opinion, the best solution at all to what is a real problem, but I am curious about something.

If this bill is so adamantly opposed, generally and philosophically, then talk about free trade with the Japanese people is asinine. It should not even be dignified by you people in treating it in the content of free trade.

You all know it. Machine tools, Mr. Ambassador, should we discuss that industry? I mean, how many examples down the line do we want to go to? What is being done in the micro chip area?

Marketing techniques and practices? I get out and talk to businessmen, too. What are we going to do? What do you suggest, that is my question?

Should the automobile industry dry up and go away? What do you suggest?

Ambassador **Brock**. First of all, I don't think I have, I know I have not and I do not think you have heard any administration spokesman suggest that the problem can be put on the backs of labor union members.

That is not the problem.

Mr. **Bailey**. I measured very carefully, Mr. Ambassador, your response to the statements that the chairman made. I did a study of the steel industry from all sides, and I have found that they have very strongly promoted productivity improvements in the industry, and I noticed you shaking your head in approval.

Those workers have not gone out there and tried to featherbed jobs. They have tried to encourage productivity improvements in the mill.

Ambassador **Brock**. Let me complete my statement, Congressman. We may end up in agreement yet.

I am not disagreeing with that, and I am not disagreeing with the effort of management, but I think you yourself made the point about jawboning. It was a former administration that did jawboning.

In the 1960's, the administration and the President yanked the president of U.S. Steel out of bed at 4 in the morning.

Mr. **Bailey**. Both sides, Republicans and Democrats for 30 years.

Ambassador **Brock**. No, that is correct, and for 30 years, or certainly for the last decade, we have found it convenient in this country to buy our way out of facing economic reality by debt, and impinged upon the capital market.

You talk about a capital-intensive industry. The point that I was nodding at was Sam Gibbons' statement that workers cannot be blamed if they are not given the tools, and you can't provide the tools for competition in a capital-intensive industry without capital.

How do you get capital when the Federal Government is sopping it all up?

Mr. Bailey. And how do you encourage investment when you have a number of trade laws on the books that our U.S. Government is obliged to help support and help defend American industry and does not use?

May I just bring into this conversation section 301.

Ambassador Brock. There is a perfect example of us using those trade laws right now in the steel industry that you cited.

Mr. Bailey. I know that story intimately, and I don't think you want to use that example.

Ambassador Brock. Well, the finding has been made of injury and of subsidy, and the application of countervailing duties will be finalized on October 15 if no agreement is reached.

The point is that the laws are being enforced. They are being applied. The Commerce Department has done precisely what the law has suggested.

The larger question, though, if I could just make this one point, goes to, I think, the real essence of your question, do we select an industry or do we create an economic climate in which all of our industries have a fair chance to compete?

I think it is fair to ask the question as to whether or not we have forgotten our basic industries over the last decade or so in this country. I think it is a fair question to ask if, in fact, our policies are adequate to deal with their competitive need now. I think it is also fair to state that they encompass something more than most tax policies. It encompasses the inability of the Congress to come to grips with the Clean Air Act, after a long time of being requested to do so.

It affects the willingness of the Congress on occasion to pass laws without considering their economic impact on jobs. It includes the inability of all administrations and Congresses to come to grips with the formation of capital and savings, the capital pool of this country which ran our interest rates up to 21½ percent.

Mr. Bailey. That is the point I made about the preferential treatment received by this industry in other countries and I wonder what we are going to do about it because I happen to agree.

What are we going to do about it? You don't like this bill. What are we going to do about it?

There is a real backlash out there. People are fed up.

Ambassador Brock. I am aware of that, but you can't respond by hurting others in this country in order to take out your anger on any other country.

If the effect of your action is to deprive people who are working honestly and earnestly in other occupations where they have something that they are selling overseas, you cannot take away their job just because you are mad at the Japanese.

Mr. Bailey. I think that has been a very unfair characterization. I think that it has been greatly magnified. There is a hyperbole attached to it that really does not fit these hearings. There is some proper criticism there, but you know I injected the issue of preferential treatment for that very reason because there are targeted industries just like there are targeted markets, for example, here in this country by some of our allies, and I think that we have to come to grips with this idea.

We do not like planning here. This whole thing boils down to a relationship between industry and Government that revolves around the issue of the governmental role in planning. You know that, I know that.

The question is in terms of trying to extend this free enterprise model that we all revere, what we are going to do to do a little justice in the world to see that it exists.

You are not going to help it by doing nothing, and basing the criticism of this bill owing that somehow it is going to violate those precepts.

Ambassador **Brock**. But we are not doing nothing. First of all, we have started trying to get bilateral investment treaties with other countries which would deny performance requirements.

Second, we have taken one of the offenders to the GATT, and we think we are going to succeed. If we succeed, we will establish the principle that it is in violation of the GATT.

Third, granted that we have made the exception with developing countries, but your problem is not with developing countries in this regard. You yourself said Japan.

Mr. **Bailey**. Mr. Ambassador, I am using up the committee's time. You and I know full well what powers are available to some attorney that wants to go into some court in Japan and get information that has to do with filing some 301 cases.

We are slowly becoming aware of that in this country. We talk about those things or make innuendos that somehow their effect just does not serve our end here.

I think this bill represents a response to a great deal of injustice, and I think there is some proof in the pudding. When we look at the arguments that are used to oppose the bill, they are assiduous and very effective sometimes, but are not going to succeed in avoiding the root causes, and that is preferential treatment in other countries that will not deal as openly with us as we generally do, and we are not perfect.

You are right about that. We are not perfect, but I sit down and look at the domestic policies of this administration and the last one. You tell me how we do something in the name of free trade by wanting to do away with the Export-Import Bank, I would like to know, because I happen to be one of its supporters.

I just don't know, and if you want to blame Congress for a lot of stuff, I am with you. I will blame them for a lot of stuff, too.

That doesn't solve our problem. Maybe some faceless or nebulous reciprocity bill will. You know better than that.

Ambassador **Brock**. The last point then. Accepting a good deal of what you have said, I don't see how you can get around the fact that in the last 5 years automobile imports are up 200,000 units. U.S. automobile sales are down 3 million units. Now, that is not because of imports. That is because of our own domestic circumstances.

Mr. **Bailey**. Mr. Ambassador, we know that part of that automobile problem in this country is simply due to some freaks of nature and variables beyond our control, buyers' preferences, cost of energy, and so forth. We know that. We all know that, but we also know that there was an American industry languishing with the domestic market because there was nowhere in the world it could go to sell a car produced in this country and market it because of what they were up against over there, and that is not management's fault.

It is not right to blame our industrial leaders in this country for that, and it is not right to blame our managers of the steel industry when this country, as a matter of foreign policy, was dedicated to exporting steel producing capacity all over the world and created or helped create the world oversupply and you are nodding your head in agreement.

Ambassador **Brock**. I do.

Mr. **Bailey**. So when you come to this room, don't take to task, and I am not saying that you are and I apologize if the implication is that you have made these kinds of statements, but we should not take to task our industrial leaders who are doing exactly what we want them to do.

We give them an environment in which to operate, say invest and make a profit, and they are damned good at it and we say to our workers out there, you have got a right of collective bargaining, you have got a wage base to maintain. You want to invest in a good home; you want to educate your kids; you want safety on the job, but we don't talk about exporting labor standards around the world.

I have to fight with you guys to talk about exporting labor standards via the CBI. That is silly.

We do have a right to maintain this and some leisure time and some decent retirement instead of being farmed out at age 55 like you are a piece of worn out leather.

Those are good goals too and they should be brought together into this discussion. This bill is a backlash, and it is a harbinger of things to come, and we had better wake up and realize that.

Nobody says it is perfect, but it is an angry way to come back and say, look, this thing has got to be changed.

If you are going to do business here, do it fairly.

One last comment. I very much appreciate the chairman being so kind with the time on this. Talk about our friend to the north; talk about their complaints over this bill. Well, I happen to know for a fact that informally they sat down and twisted arms on the issue of domestic content against a foreign automobile producer who wanted to make a decision to invest in the United States of America, but did not because they would have been denied access to the market in Canada had they not invested in manufacturing facilities in that country.

You try that. You try that as a special trade representative in the United States. What is going to happen to you? What would happen to you if you did that? You would be down here being chewed to pieces, and yet it is a Government policy there. Ridiculous. We have got to grow up. We are in a tough competition out there. We had better learn to compete.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman.

I want to thank the witnesses for their testimony today. I think we are beginning to shed some light on a bill that has been nurtured in the darkness for the past year. It has been promoted without hearings on some of the basis that misery loves company, and as long as the automobile industry is down, we should knock a few other industries down and see if we can wreck the whole country in one fell swoop.

I believe we can do so with this kind of bill.

Ambassador Brock, on page 1 of your testimony, you compared this with Burke-Hartke and Smoot-Hawley. Smoot-Hawley we should have learned from because we exacerbated a worldwide recession that took a war to cure. Nobody is looking for that kind of a cure for the future.

Burke-Hartke, I think, was rightfully ignored by the Congress. Why is local content other than the fact that we have never had a chance to debate it or have anyone talk about it, why is local content not being considered in the same terms as those two odious pieces of legislation?

Mr. BROCK. I think it is now, as we begin to really look at what it would do, but the previous questioner, I think, indicated very eloquently the frustration of people who see an industry that is in trouble, and are looking for almost any answer.

I happen to think it is the wrong answer, but that is what is going to come out in the hearings. That is what this conversation is all about.

Mr. FRENZEL. You indicated that the consumer will pay $5 billion more when the local content bill is in full force and effect, and you queried as to why we couldn't appropriate $5 billion.

I think the answer is obvious, that the Congress wouldn't do that.

Ambassador BROCK. That is right.

Mr. FRENZEL. For a specific industry.

Ambassador BROCK. That is right.

Mr. FRENZEL. And I guess I share your concern. We would be willing to in effect lay $5 billion off onto somebody else to take care of a problem, or rather, to give some anticipated temporary relief to a problem that we probably won't be solving.

That is one of the really bad parts about this bill.

The other part that bothers me a little bit, one of the reasons it didn't come to this committee in the first place, is that this bill doesn't talk about any of you people who are in the trade business, and yet its whole intent is to stifle U.S. trade.

The only Secretary mentioned is the Department of Transportation. Does that Department, in your estimation, have any business managing a trade bill?

Ambassador BROCK. No, sir.

Mr. FRENZEL. Secretary Baldrige, recognizing that DOT is a sterling crowd, should they be the ones that are doing studies of automobile parts manufacturers? Would you answer that?

Secretary BALDRIGE. No.

Mr. FRENZEL. Who should be doing it, sir?

Secretary BALDRIGE. Department of Commerce.

Mr. FRENZEL. How interesting.

Secretary McNamar, under this bill it is the Secretary of Transportation who tells the Customs Service when it can admit automobiles and when it cannot.

Is that the right way to run a railroad, or even a trade policy, in your judgment?

Mr. **McNamar**. I think not.

Mr. **Frenzel**. Should it not be modified to put the Secretary of the Treasury in his rightful position, so that he can make judgments as to when the law, if we are so unlucky as to pass it, needs implementation?

Mr. **McNamar**. I would think so, yes.

Mr. **Frenzel**. Secretary Baldrige, on page 3 of your testimony you raise the question of whether under this kind of a bill the U.S. manufacturers are giving up the world market.

I have a problem with that too. This is sort of a "Stop the world, I want to get off" bill. It means that we insulate and isolate our market, and absolutely eliminate our opportunity to sell abroad. Why do you suppose the auto manufacturers have not been more vocal in trying to protect what seems to me to be a lucrative and expanding market abroad?

Secretary **Baldrige**. Well, I don't know, Congressman. I can only assume that they are trying at this time to get along on a new step of friendship with the unions, new contracts, new negotiations.

They don't want anything to muddy the water now. That is an assumption solely. I have no direct knowledge of that.

I may add that I would hope that they would, when they are called on to testify, in fact come out against this legislation.

Mr. **Frenzel**. I guess we will come to that stunning conclusion here in a couple of days. You indicated the number of losses that would be incurred in port facilities, and in investment or, rather, in jobs of foreign-owned automobile companies.

You didn't give us specific figures of how many people might be unemployed in automobile agencies of imported automobiles or maintenance facilities or whatever.

Do you have those figures?

Secretary **Baldrige**. Yes. We would estimate that probably after a 2-year period that 200,000 jobs might be picked up in the automobile industry, if this bill were passed, and probably 65,000 to 100,000 jobs would be lost because of the ports, the import dealers, mechanics and so forth, so you would end up with a net of somewhere around 100,000 jobs plus.

If I can bring out one other point, Congressman, on the 400 billion dollars' worth of trade that Ambassador Brock said that we did worldwide, I think we would all agree that you could argue about whether it is 25,000, 30,000 or 35,000 jobs for every 1 billion dollars' worth of exports we do.

All we would have to do is have a 1-percent retaliation there, and we would lose 4 billion dollars' worth of trade, which would be 100,000 jobs wiped out with a 1-percent retaliation factor.

I might further add that in 1979 and 1980 just our surplus in world trade in manufactured goods and in farm products averaged about $40 billion a year for those 2 years.

A 10-percent retaliation there, which is very easy to see, would wipe out any effect of this, and I fear that retaliation would go long beyond this. It is not just the direct retaliation. It is our loss, complete loss of credibility in the world forum, in speaking out or trying to lead any efforts toward further trade, or stopping other countries from putting up protectionist barriers.

We would really have soiled hands on trying to lead anything like that.

Mr. **Frenzel.** I agree with you. The Congressional Budget Office Director, in response to the chairman's inquiry, released a report on September 17, part of which reads as follows:

> For the total U.S. economy, however, the net effect of the substitute bill in terms of real economic growth, inflation and employment, would be slightly negative, assuming that the United States trading partners retaliated in kind.

Now, I think that is a pretty good assumption based on what happened in the thirties. In other words, the benefit that would accrue to the U.S. automotive industry would still probably be more than offset by the costs imposed on the rest of the economy, despite the important lenient provisions of the Ottinger substitute.

Do you agree with Director Rivlin's statement?

Secretary **Baldrige.** Yes, I do. I think she backs up what we have been saying since we first studied this.

She backs up what the Council of Economic Advisors, Mr. Niskanen, who is here on my left, has been saying. To go back to that one statistic I gave you before in 1979 and 1980 we had a $40 billion surplus in manufactured goods and farm equipment. That is the equivalent of about 1,200,000 jobs that we are putting at risk in order to pick up 100,000 plus. The odds aren't with it.

Mr. **Frenzel.** Exactly. Ambassador Brock, have you ever traveled to Australia, Spain, Turkey, or Brazil? Greece, I mean.

Ambassador **Brock.** Some of those and a few others, yes.

Mr. **Frenzel.** Were you ever possessed of a great desire to buy one of their very efficient, attractive and comfortable automobiles?

Ambassador **Brock.** In all honesty, I can't afford their cars.

Mr. **Frenzel.** I think the proof of this turkey is in the eating, and those who have eaten it have choked on it.

I haven't been to all those countries either, but I have been to some of them and I have yet to hear any person in government, on the street, or in business, say a good word for those laws, with the single exception of those who produce the automobiles, and have the guaranteed market for the automobile within their country.

Is that your experience?

Ambassador **Brock.** Not only is it my experience, but I think you will find that the average person in those countries can't afford a car because the price is so high and the quality is generally not good. The consequence is for a much, much smaller automobile market in the country.

I guess that is one of the great concerns I have here. People can't afford to buy a car today in this country with high interest rates. The monthly payment is so high when you get to a $10,000 price tag and you put 13-, 14-, 15-percent interest on it, your monthly payments just eat you out of house and home. That means we will sell less cars, and that means less people will be working to produce those cars.

That is exactly the experience of every one of those countries, so it isn't a matter of theory. It is a matter of fact. It is the experience that has been proven by years of experience.

Mr. **Frenzel**. Yes, and whoever has used this system has wound up paying a tremendous economic price.

Ambassador **Brock**. Yes, they have.

Mr. **Frenzel**. I understand in these countries that have this the price of foreign cars gets bid up the way prices of homes did in California a couple of years ago. A car had to change hands six or seven times before it got up to an appropriate price above the local content model produced in those countries.

Ambassador **Brock**. Right.

Mr. **Frenzel**. Secretary McNamar, you claim that there is a hidden inflationary tax in this bill.

Do you want to be a little more explicit about that statement?

Mr. **McNamar**. There is a hidden inflationary tax in this bill in that the price of a U.S. car would be higher as a result of a direct Government action, indeed, action that might come out of Ways and Means Committee, that would in effect be an indirect tax on anyone who would buy the car in the United States. Moreover, I would suggest that it is a regressive tax because most people who buy cars have to spend a significant proportion of their income to buy that car, and they would be spending an increased proportion of their income to buy that car as a result of a government action, if this particular piece of legislation were passed. Therefore I think it is appropriate to think of it as an indirect tax upon the purchasers of the cars, and that the tax revenue is directly transferred to the automobile workers and the automobile company profits as a result of the local content legislation.

Mr. **Frenzel**. Thank you, Mr. Secretary.

Gentlemen, I have overrun my time, too. I have some other things I would like to talk about.

At the moment I yield.

Chairman **Gibbons**. Mr. Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman.

I too would like to thank our panel for their testimony. However, as I listened, it seems to me as though you view this action as if it were happening in a vacuum, as if we are doing this unilaterally and that we will invite retaliation.

That is not the case at all because what this is, pure and simple is, retaliation, period.

In the 6 years which I have been on this subcommittee, I have seen endless negotiations, discussions and hoped-for breakthroughs, none of which have accomplished a great deal.

The time has come to say—I realize this is not the most perfect vehicle—the time has come to say enough.

We are no longer going to rollover and be the patsy, and so it seems to me this is and should be explained as specific retaliation, and if this is not the way to go I personally would be happy to have suggestions as to the way to go.

I think we have had enough negotiations. I guess the first question from all the reports I have seen, all the negotiations and all the pious statements which have been coming from the other side of the Pacific have not really accomplished much.

Are there any good, positive signs that you see that are going to accomplish something, or are we going to have to go through with some kind of retaliatory legislation?

Ambassador **Brock**. We have had three rounds of liberalization of varying degrees on the part of the Japanese Government and I assume that is whom you are talking about, one in December, one in January, one on May 28. There is, as you well know, a good deal left to be done, but I guess if we are going to talk about this particular bill, I would like to know what we are retaliating against.

Retaliation implies that the other side is unfairly subsidizing competition into this market. I don't know of any evidence of that fact. I accept the argument that the industry was protected for years.

Mr. **Schulze**. I would be happy to answer the question specifically for you, Mr. Ambassador.

Let's just take one area and that is television.

Ambassador **Brock**. Wait a minute. We are talking about cars.

Mr. **Schulze**. I know we are talking about cars, because our television industry is dead. Are we going to kill our automobile industry the same way we did, or computers, or aircraft, or what is to come in the future?

I think it is time we say, "Enough; stop."

We are not going to allow other industries to be dissipated the way our television industry has been. If you have another way to do that, or if you see other countries who are saying we realize that we were wrong, in my opinion if you see someone who has been extremely successful in the area of foreign trade and foreign endeavors and international trade, perhaps the best thing to do would be to emulate that which they have done. It seems to me that is what we are doing.

We won't go into the whole story of what they did with our television industry, but in my opinion it is a classic case of successful protectionism.

You build up your production, your productive facilities, your local market and then penetrate the overseas market. I view this as an opportunity to give your domestic producers that same opportunity, that breathing space, that time to gear up to absolutely go out and penetrate other markets.

Ambassador **Brock**. I guess I don't accept the breathing space argument.

I have never known the Congress to do anything that it called temporary that didn't last for a few centuries.

We passed a temporary income tax in 1913, and you all are still wrestling with it.

Mr. **Schulze**. I share your concerns in that area.

Ambassador **Brock**. We passed a temporary protection for the textile industry in 1962 and it has just gotten tougher every year since.

Mr. **Schulze**. Why should we not emulate the Japanese policies? Why should we not say, gosh, aren't they marvelous? They have been so successful, let's do the same thing.

Ambassador **Brock**. Because we are not Japan. Because we are a different society.

We don't have the capacity and I don't think any of us want it in this Government, whether in Congress or in the administration, to select winners and losers in this country. If that is what you are suggesting.

That is not what you are suggesting, but that is the implication of this particular approach. I don't think the American people would ever want a government to do that.

Mr. SCHULZE. Your alternative is to destroy our industrial base, have our industrial base destroyed. I don't think we can stand by and allow that to happen. Each of the various trading partners around the world, if they selected one of our major industries and specialized in penetrating ours and destroying our industrial base, we would be abrogating our responsibility if we sat back and allowed that.

Chairman GIBBONS. While the Ambassador is thinking, I think they picked automobiles out as being a loser.

Ambassador BROCK. That is correct.

Chairman GIBBONS. And did not pick it out as being a winner. The automobile industry in Japan is privately owned and not subsidized and went out and proved that Miti was wrong in this regard. The Japanese Government has put restraints on the automobile industry rather than subsidizing.

Ambassador BROCK. The point is absolutely correct. There is a larger point too, Mr. Chairman, and my friend from Pennsylvania. That is that we still export more than we import in manufactured goods, in services, in agriculture, and I grant there are serious, serious problems in our capital-intensive heavy industries.

The gentleman from Pennsylvania is right on the money in raising the issue, and asking that we address it. I just think this is the wrong way to address it. It does require us to take a look at what we have been trying to do. This administration has tried with its tax policy to restore the capital pool in this country, savings and investment, reducing taxes on business and on individuals, to give us a chance to restore our competitive edge, but you know in trade policy you have to go one of two ways.

You can either have a policy for every different industry and for every different country, in which case you have got no policy at all, and the world is going to collapse into unbelievable chaos, or you have got to have a generic policy that works across the board and you have got to say that when practices are unfair, we have a responsibility under U.S. law and international agreement to act, and if the international agreements are not adequate, then doggone it, it is our job to strengthen them.

That is why we have called for the Ministerial this year. I think we are going to make some progress in the Ministerial. It isn't going to change the world but at least we will lay down something that is appropriate.

Mr. SCHULZE. I hope you are correct, but quite frankly I view this legislation or some similar legislation as perhaps the only hope of getting some liberalization around the world because if they continue to view us as being patsies, that we are going to roll over and take anything with our free trade policies that they are going to hand us, I don't think we are going to get progress from anywhere.

Ambassador BROCK. It is astonishing for me to go around the world and have people say you know the United States has conned us for the past couple of years. Every time we got in negotiations with Bob Askew or Bill Dent or Christian Herter, you guys always come out on top and I come over here and all I ever hear is that every previous trade negotiator has been a patsy with the country.

We have benefited enormously from this world trading process. We are ahead of the game. We have been ahead of the game for 35 years. Granted, we have got troubled industries, but that is not because of international competition.

Mr. SCHULZE. Mr. Ambassador, I think things are changing, if I read the signs. I keep coming back to the television example, because it was a selective penetration which destroyed a domestic industry, and that was successful, and if I were in some other nation, and I were the trade minister or trying to develop the internal industries, I would say, gosh, look at that. That is an ideal way to operate. Let's do that. And I think we have to send a message that we are not going to be patsies for that kind of operation.

Ambassador BROCK. I don't disagree with that. I don't like the targeting and I am very uncomfortable. We have discussed it. It is very difficult to get a handle on in an international agreement. You are probably going to end up putting more emphasis on bilateral approaches than you are on multilateral because it is a tough thing to get a legal handle on.

Mr. SCHULZE. That is why I say do you have some other suggestions?

I think what we are handing you is a negotiating tool because you can go over and say, look, there are a bunch of crazies in that Congress, and if you don't shape up your operations, they are really going to shove it to you, and I would be happy to be one of those that you can point to if you want to, beause I am sick and tired of their exporting their unemployment to us.

I think this is what they are doing. I think it is deliberate, and I think we have to send a message, and if this is not the vehicle, let's develop one, but the message must be sent.

Ambassador BROCK. If I can make a parochial pitch, we have had legislation before this committee which we would like very much to see passed, which would strengthen our negotiating hand.

Mr. SCHULZE. I too have run over my time and I thank you, gentlemen, and I thank you, Mr. Chairman.

Chairman GIBBONS. Mr.Vander Jagt?

Mr. VANDER JAGT. Thank you very much, Mr. Chairman.

I would like to thank the members of the panel for being here this morning, for the information you have provided, the answers you have given, and the patience that you have displayed.

I think this morning you have probably shed more light on this bill than in all of the congressional hearings up to this point or lack thereof. We thank you very much.

If I could just very briefly follow up on Congressman Schulze's point of giving you an opportunity to point to the crazies in the Congress, perhaps strengthening your negotiating hand. In the Energy and Commerce Committee, an amendment which would have made these import restrictions discretionary was narrowly defeated.

I think it was defeated by only one vote. If they were discretionary, and didn't have to be applied, or could be applied, if a country was not cooperating in the reduction of other very significant unfair trade barriers that we all recognize, wouldn't that in effect strengthen our Government's negotiating hand?

In fact, I don't think you would just have a gun at their head. I think you would have a cannon at their head.

Ambassador **Brock**. Well, you would have a cannon or an MX, I am not sure which. Yes, it would strengthen your short-term hand. In the long term, the utilization of that kind of a blunderbuss would I think run the same hazard that the mandatory legislation would have.

We do need more flexibility in [illegible] policy in our negotiating policy. We have sought it in a number of areas, and I guess I get a little woozy because when I come up here on one bill, the Congress wants to give me more flexibility and on another wants to take it away and you all have all of those bills in front of you.

I wish somebody would make up his mind.

Maybe I am shifting my ground too on occasion. I hope not, but I think it is fair to state that the use of local content legislation, whether it is mandatory or not, if it is used, poses such a really serious threat to your ability to deal with the development and liberalization of a multilateral system that I can't imagine a new administration using it. Therefore it seems to me that it would be unwise to pass it because you would put in our hands a tool that would constitute a threat, and I am not sure we can afford to pick up on Congressman Schulze's point; we can't afford to threaten, unless we are willing to really go after them. There are other ways to go after them that I think can be more effective, and achieve the larger goal we have, which is a substantial expansion of the U.S. economy and the creation of jobs here by improving our competitiveness overseas and the market opportunities overseas.

Mr. **Vander Jagt**. I appreciate very much that answer. I assume though that all of us agree that if there were going to be a bill discretionary would be infinitely preferable to mandatory.

Secretary **Baldrige**. I think if it was discretionary, there would be so much pressure to use it that it would be very difficult to resist.

Mr. **McNamar**. The problem I think with the discretionary formulation is simply that it would exacerbate the political considerations, and would ignore the economic realities. There is no reason to think that the executive branch of the Government is any more wise or sagacious than the Congress and cannot be subject to the same pressures although perhaps not on the same 2-year basis.

Mr. **Vander Jagt**. Thank you very much. Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Jenkins?

Mr. **Jenkins**. Thank you, Mr. Chairman. I, too, want to commend Ambassador Brock and the administration for attempting to make some headway in a host of areas, and I sympathize with your daily ordeal. I do think that you have attempted in almost every instance to be of service to the domestic industries.

I do have some questions. Obviously this is an issue that concerns all of us, and no one on the panel is perfectly happy with the prospect of having to resort to this type of legislation, domestic content legislation.

Nevertheless, I think that there is some justification, and I want to address retaliation and talk about Japan for a moment. You might have discussed this while I was temporarily out of the committee room.

If we take a look at the airlines industry in Japan the major international carrier in Japan is owned 40 percent by the Japanese Government, with the balance of it being in private hands. Two or three years ago there was domestic content legislation from Japan apparently, in the form of pressure from this company with McDonald and other companies here, to insist upon domestic content before an award was let with American companies.

Now I recognize that this was not a law in Japan that required a certain percentage of domestic content, but there is no difference, is there, between the two? What is the difference between the Japanese Government through its subsidiary aircraft company in demanding domestic content before it would enter into a contract for the purchase of aircraft, and us doing the same thing on automobiles? What is the real difference?

Ambassador BROCK. I don't think that they have. The joint construction contracts that we have, I don't know the precise figures, but it seemed to me like in the case of Boeing, the aircraft that were to be built there were about 17 percent local content. I guess I am the wrong person to answer, but I don't believe that was mandated by Government.

Mr. JENKINS. It was mandated, Mr. Ambassador, really you are right. It was mandated by the airline company which was owned 40 percent by the Japanese Government. That is the difference.

Secretary BALDRIGE. Mr. Congressman, that was a negotiation between Boeing and the Japanese company. Japan does not have a local content requirement for aircraft. They are producing about 17 percent on a risk-sharing basis with Boeing. It happens that they produce about 17 percent of the values of the Boeing 767's over there, and I think one airline, one Japanese airline has ordered about 25 of these 767's. We look on that as a regular business arrangement.

Mr. JENKINS. Do you look upon that as a regular business arrangement when the Japanese Government owns over 40 percent of that company that is demanding that domestic content?

Secretary BALDRIGE. We are going to see that worldwide. In France the banks are all nationalized. A great many of the companies are. Whether we like it or not, we are going to be doing business, our private companies are, with Government-owned or partially-owned companies around the world.

Mr. JENKINS. So that is the real dilemma that we are in here because, while the Japanese can say we do not have domestic content legislation, in fact they do, if they require it through a company that they own, or have a substantial ownership in, wouldn't you agree with that?

Secretary BALDRIGE. A regular company could say the same thing, Mr. Congressman, if that company was not owned, if they want the business right there because they want their share of the profit, they could do the same thing.

Mr. JENKINS. I understand that, but I think that is another ballgame. This is a company that is owned substantially by the Japanese Government that has over 40 percent of all of the international carrier business in the entire country of Japan.

Ambassador **Brock**. If that ownership impacts on the decision, Congressman, that is a different matter, but if it doesn't, if it is a separate business transaction, then we have no right to criticize them or Boeing or anybody else, as long as people enter into a business relationship on the basis of the economic merit of the relationship.

Mr. **Jenkins**. But we are simply giving them an escape route. We are saying that so long as even though you control the company, so long as there is not a statute on your books, even though in fact that is what you do, you have a domestic content requirement, which was true in this purchase, that it is acceptable.

Ambassador **Brock**. I think we are making a very clear distinction between a government policy which mandates an action regardless of economic merit, and a straight business deal where our companies have a right to make their own decision as to whether or not it is in their interest to go into that deal.

Mr. **Jenkins**. What if that particular company was owned 100 percent by the Japanese Government, would that make any difference to you, then?

Ambassador **Brock**. Not at all, if our company felt it was in their interest to cut that particular deal and they had a clear economic incentive to get that business and they wouldn't get the business otherwise, yes, I think that is a legitimate thing for our companies to do.

Mr. **Jenkins**. Now, the fallacy, I respectfully contend, of that position is simply this. When Japan tells Boeing or whomever, you are not going to get this contract unless you agree for 25 percent or 20 percent of the local content to be supplied from Japan, then it eliminates us entirely. That is what happened in this particular transaction.

Ambassador **Brock**. No, I don't think the Japanese Government did do that.

Mr. **Jenkins**. Well, the Japanese company owned by the Japanese Government did that, and I fail to see the difference. I fail to see the difference between the two. If that is acceptable, then we are going to get out traded without any question not only in Japan but across the world.

Ambassador **Brock**. Picking up on the Secretary's comments, Congressman, I would ask you to think with me for a time, it isn't going to be an answer I would ask for today, but sometime in the next few months I would love to sit down with you and other members of this committee, if you like, and talk about how we cope with the increasing problem we have with mixed economies and what that portends for U.S. trade terms.

I accept that as a question. I don't think in this particular instance you can use it as an example of a subterfuge to get around local content, because I don't think the decision was made on that kind of an economic or political basis rather than an economic basis, but I do think you are right in pointing up to the hazard we face with the increasing nationalization of firms in countries, France, and other places, in this kind of a market circumstance.

Secretary **Baldrige**. We see that increasing all around the world, Congressman. Country after country has gotten partial or total ownership of their industries and their banks. That is the world we are living in.

Ambassador **Brock**. With all respect to some of the comments that have been made about my predecessors, I might point out that Ambassador Strauss, when he had this job, foresaw this particular problem, and negotiated a Govenment procurement code.

It did not have full application because a lot of countries simply wouldn't go into it fully, but we are still pressing countries to join the code. We are still pressing for an extension of that code, but that is the only multilateral approach we presently see to answering that question.

Mr. **Jenkins**. Mr. Ambassador, I was referring to a $4.5 billion agreement that was entered into with Japan sometime ago, several years ago. At that time one of the officials indicated, of McDonnell Douglas—first of all, most domestic airframe builders agree that a refusal to share substantial amounts of production with offshore plants or even handing over the prime construction and final assembly roles would result in their exclusion from overseas procurement programs. And then I quote the McDonnell Douglas official:

"If we made these the conditions for the sale of the F-15's to Japan, they would be flying something else."

They had to comply. They had to agree to the domestic content requirements, or they would be eliminated as they have been in other instances, and I simply fail to see the differences, is my point.

If it were entirely a private company without any Government ownership or control, I would agree. Where the Japanese Government owns a substantial portion of the company, I think it is the same.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Downey.

Mr. **Downey**. I would be very anxious to hear you wax eloquent on the notion on how we are going to compete—in a world of mixed economies where the governments of other states are actively involved in industries—specifically in the cases of the airline industry and the manufacturing industry.

It is clear that the Airbus people in France, Britain, and Germany are making inroads in Asia because of financial schemes that the government supports actively, whereas Boeing and McDonnell Douglas and Lockheed, even with their new products, are not able to meet cost competition, because they are not subsidized by their government. How we make that playing field level is of interest to all of us.

Mr. Ambassador, let me ask you first, you made reference before to the fact that this bill would violate GATT. Doesn't the Caribbean Initiative also do some violence on its face to the GATT agreement?

Ambassador **Brock**. Yes. We are required to seek a waiver of the GATT rules when we pass that kind of legislation, and we intend to do it.

Mr. **Downey**. So it is possible that if we did this, that we could also ask for a waiver for GATT for domestic content could we not?

Ambassador BROCK. I don't know whether people would laugh or cry if we made that kind of request, Congressman, but they surely would not respond as we want them to respond in an effort to help a few small countries as the Caribbean Initiative does.

Mr. DOWNEY. Let me ask you to detail what the Japanese have done, if anything, to countries that have domestic requirements as part of legislation. Have they retaliated in any way that you are aware of?

Ambassador BROCK. Not to my knowledge.

Mr. DOWNEY. Let me ask you also about the cost of free trade. We will pay this year some $20 billion in unemployment compensation. A portion of that will go to the offshore industry. We used to have a Trade Adjustment Assistance Act that despite the fact that it costs a lot of money was the sop that we held out to the automobile worker, saying: OK, listen, if you go out because of our policies of free trade and nonprotection, we will insulate you to a certain extent.

Now, we have done away with trade adjustment assistance for the most part with the exception of some money for training.

You pointed out that this would cost the American consumer about $5 billion additionally if we were to pass this bill. Isn't that a cost that we are going to incur one way or the other, Mr. Ambassador, with or without this legislation, either with unemployed auto workers, with money for retraining, renewed trade adjustment assistance? Classic economists ask two questions:

What is its value to me, and what must I give up to have it? If we want to have free trade, it is going to cost us one way or the other, either through unemployment compensation or through some process here of protecting an industry and keeping the workers at work, even though you know it is costing you more money.

A shorthand question, it is going to cost us money one way or the other. Is it better to make it in unemployment compensation or is it better to do it this way?

Ambassador BROCK. If it were a question of money, I don't think you would have us arguing with the intensity that we are arguing. My argument is not that at all, but I don't know how, Congressman, you can suggest that it is either fair or economically logical for this Government to tell a farmworker or pharmaceutical worker or a worker in a communications or a computer company that they are going to be thrown out of work by the action of their own government in order to protect somebody in a different industry. That is a matter of not only economic logic but it is a matter of equity.

Mr. DOWNEY. I don't mean to interrupt you, but it is your impression that if we enact this, reciprocal action will have a negative impact on those export-dependent industries in this country?

Ambassador BROCK. I think the costs in international export opportunities could exceed the domestic cost by a factor of 10, 20 or 30 to 1.

Mr. DOWNEY. I take your word for that. I have not seen studies that indicate that. You are closer to this than I am. I question whether it would be that big. You are saying that that tradeoff as well as the principle of not having something like this written into statutes, is a cost that we can't afford.

Ambassador **Brock**. I am not here arguing theology. I am not here arguing a purist free-trade stance. None of us are. I am suggesting to you that the best judgment I can give you, as the person who has to engage in these negotiations, is that this would trigger a response in countries other than that which we are addressing, and that is Japan, that would be of enormous negative consequences.

Mr. **Downey**. Thank you.

Chairman **Gibbons**. Mr. Pease, before I recognize you, let me make an administrative announcement. First I want to commend all the committee members for taking this matter so seriously. I look at the clock and realize we have already spent more time on this than all the hearings in the Commerce Committee, which kept this bill bottled up for over a year. In order that we may take care of our other congressional business, after Mr. Pease and a few followup questions that I have and others may have, I am going to ask the other witnesses to please come back at 2 o'clock. Is that agreeable?

The other witnesses will come back at 2 o'clock. I am sorry that we are taking up so much of your time, but, as I say, this is perhaps the most important piece of economic legislation we have had in a long time. Mr. Pease.

Mr. **Pease**. Thank you, Mr. Chairman. I apologize to the witnesses for arriving late and missing their testimony, so I am not as comfortable asking questions as I would otherwise. I would just like to pick up a bit, though, on a comment the Ambassador just made about the tradeoff.

You said that we would lose trade in the realm of 10, 20, or 30 times as much as we would benefit from this bill? Can you possibly mean that?

Ambassador **Brock**. I think I would rather not try to overstate the problem, but I am intensely aware of the present threat to the world trading system without this legislation. The world financial circumstance is extremely fragile. We just had meetings in Toronto about the IMF, the possible default of major countries in terms of debt and the impact that that would have on trade would be absolutely unbelievable.

We have had in the last year the first decline, net decline in world trade since World War II. It is the first year in which we haven't had growth, and really spectacular growth, exponential growth. It seems to me that at this precise time for the United States, which has led the call for liberalization and has benefited massively from international trade going from $40 billion in 1960 to $260 billion last year, we have the most to lose.

I guess it is unfair for me to put that kind of a number on it, because I don't know what the consequences are. I just have the very, very real feeling that it could be of greater consequence than any of us dream about.

Secretary **Baldrige**. Mr. Congressman, can I follow up on that for a minute, please?

Mr. **Pease**. Surely.

Secretary **Baldrige**. This is not just a problem in the United States. This is a worldwide problem. We are in a worldwide slowdown of GNP all around the globe. What we are going to see and are seeing is a rise in protectionism in all countries, not just the United States. That is No. 1.

No. 2, it is going to be particularly exacerbated in the developing countries with large amounts of debt—such as Mexico, Brazil, Argentina—that you have been reading about whose problems we hope the IMF can solve. But those are external debts, and external debts have to be paid off more or less by export.

That means that all of those countries are going to put an additional drive on to get exports out by any possible means, and they are going to try and lower their imports, so we are in effect in a period where it is so easy to retreat to protectionism.

During the period since World War II we have gained far more from free trade as a nation than we have lost—certainly there have been adjustments in different industries as this has gone on, but overall the United States has been by far the greatest gainer from free trade. We are about to go into a period where we will see cries for protectionism around the world much greater than we have seen since World War II, and for us to abrogate the leadership on this, or to take a step backward, is going to give the signal to everybody else that they can be off to the races and we will not be sitting there with clean hands being able to lead them. That is a part that worries both of us.

As to the exact figures I mentioned earlier before you came, that if you just took the manufactured goods area, which includes automobiles, and agriculture, we have run a $40 billion surplus in 1979 and 1980 average, $40 billion.

Mr. **Pease**. Excuse me, Mr. Secretary, could you break that out as between agriculture and manufactured?

Secretary **Baldrige**. About 25 would be agriculture and about 15 manufactured goods in total. Now that translated into jobs, some people use 25,000 jobs per billion, some use 30, some use 35. Just take 30,000 jobs per billion. That is 1,200,000 jobs we are putting at risk in order to save theoretically 100,000-plus. That is 10 to 1 so you would only need a 10-percent retreat to protectionism and we couldn't lead our way out of this kind of a situation, where we would be worse off than before, and the consequences beyond would be much more far reaching.

I agree with the Ambassador. We would end up probably with more than 10 percent. I mean, how can you estimate? I don't know, but it is the whole thrust of the way the world is going, and we have to be especially careful at this time.

Mr. **Pease**. It would be a 10-percent loss on our part, our trade?

Secretary **Baldrige**. There are no scientific figures. We don't know what is going to happen, but let me say that just in our surplus in manufactured goods and farming, we have at risk about 1,100,000 jobs.

Ambassador **Brock**. Just in the surplus.

Secretary **Baldrige**. Just in the surplus part. That is to our advantage, we are that far ahead. Now on this bill, our best estimates show that it would pick up 200,000 jobs, but we would lose another 65,000 to 100,000 jobs through the docks, the import showrooms, and so forth, mechanics, et cetera, so you are talking about a net of 100,000 to, I don't know, 125,000 jobs.

But you have got 1,200,000 jobs at risk just from our surplus in those areas. In free trade, some industries will get hurt. That is a process of adjustment that goes on worldwide, not just in the United States. It is going on in Europe right now and it is going on in Japan, in their steel industry that we hold up as being a model. We are seeing South Korea start to make inroads there and have the Japanese steel industry in the next 10 years start to shift to Southeast Asia more.

So just because we are in a difficult time now, we do not want to throw away the whole fabric of our free trading system, because we have gained a lot more from it than we have lost.

Mr. PEASE. You mentioned a 10-percent loss. It is difficult to quantify, I know. The Ambassador mentioned a tradeoff in the realm of 10, 20, or 30 times. That would be 1,000 percent, 2,000 percent and 3,000 percent. That is a lot different from 10 percent.

Ambassador BROCK. No.

Mr. PEASE. In the administration, could you reconcile those two figures?

Ambassador BROCK. To be sure we are using the same figures, the Secretary is talking about a 10-percent change in our total trade. In export terms alone, that runs better than $20 billion, if it was 10 percent. If you are talking about 10 times, I was talking about 10 times the anticipated cost domestically, and that is a very different and a very low number compared to the gross huge volume of trade we have in international trade.

We are, I think, using essentially the same numbers, but we were talking about two different aspects of the problem, one the domestic impact, the other the international.

Mr. PEASE. If I might before the bill comes to the floor, Mr. Ambassador, could you give us even a rough set of figures that would show us that magnitude?

Ambassador BROCK. I would be delighted to.

Mr. PEASE. Let me ask the Ambassador or the Secretary, Who would retaliate againt us in the domestic content bill? The Germans? Volkswagens are already being produced in this country. The French Renault is already producing in this country. All of the European countries have restrictions on the import of Japanese cars.

Obviously, the Japanese would be unhappy, but I think as one of you replied to Mr. Downey, the Japanese don't seem to be retaliating. Their companies are prepared to produce here. Would there be any direct retaliation? Isn't this a little situation among the auto-producing countries of the world, which are rather few in number?

Ambassador BROCK. Let me clarify first the statement that you made about other countries having limits on Japanese automobile. So do we, self-imposed by the voluntary agreement, the Japanese have a limit of 1,680,000 units. Other countries do have limits on Japanese automobiles.

They do not have local content rules. There is a very, very sizable difference between the two approaches. The voluntary agreement is a much less damaging approach than is domestic content, which would raise consumer prices and trigger something much larger. That is what I was talking about earlier.

I am not sure that I know how to predict "X" country will retaliate in "Y" fashion. I can say with a great deal of assurance that if the United States were to pass domestic content legislation, it would be a sign to all of the major countries and the developing countries to do likewise.

The contraction in world trade that would occur as a consequence of eveybody playing begger thy neighbor would be of a magnitude that the only analogy I have been able to draw is the Smoot-Hawley action of 1930, which by every economic analysis I have ever read on either side, liberal, conservative, Republican, Democrat, foreign or domestic, that tariff had the effect of extending both the depth and the duration of the greatest depression of this century, and to think that we would follow a similar path is just not rational.

Mr. **Pease**. Would you be comfortable negotiating with the Japanese a voluntary limit which proportionately would be equal to the limit that the Italians have managed to negotiate with the Japanese on the import of Japanese cars?

Ambassador **Brock**. That who has negotiated?

Mr. **Pease**. The Italians.

Ambassador **Brock**. No, absolutely not.

Mr. **Pease**. I think that would remove a lot of the pressure for this kind of legislation.

Ambassador **Brock**. It would. It would achieve the same result, no imports.

Mr. **Pease**. You mentioned voluntary restraints are much preferable to a bill of this sort. Why couldn't we just say to the Japanese: If the Italians can set a given percentage and it is satisfactory with you, why don't we do the same thing?

Chairman **Gibbons**. It would be a violation of our antitrust laws.

Mr. **Pease**. Certainly, Mr. Chairman, the Ambassador has just told us that we have negotiated a voluntary limitation on the part of the Japanese.

Ambassador **Brock**. I think "negotiations" is an excessive word. "Consulted" would be the proper word, I think, but the point is, I think, fairly simply stated. As I said in my testimony, imports in the last 5 years have gone up only 200,000 units out of a market at that time of 10 million cars.

Domestic automobile sales from a 9 million car market down to 6 million car market, we have about 6 million units. How can you say that it is imports that caused the problem? It is the domestic economy, it is interest rates of 21½ percent 2 years ago, the slowdown that occurred in the basic employment of all Amricans as a result of that, the inability of people in this country to make monthly payments at these interest rates.

That is the problem, and this bill doesn't touch that at all. So, the Japanese-Italian arrangement—it is not an arrangement, it is an imposed thing from Italy—doesn't address that, and it wouldn't address our problem.

The voluntary agreement was not a happy approach. I happen to think—well, I know if we had a healthy economy then it could be done without any agreement at all. But if you are going to have any approach that constrains imports, and that one did, it rolled them back by 7 percent, it at least allowed enough automobiles to come into this country to maintain a competitive choice for our consumers, and it did not increase the price of cars across the board for all purchasers of those cars, and it did not violate any single international agreement we have, and it did not trigger a retaliation or a collapse of the world trading system. All of which I think you could argue might occur as a consequence of this kind of an action.

Mr. PEASE. I don't want to belabor the point, Mr. Chairman.

How about the French? Would you feel comfortable negotiating the same kinds of limitations on Japanese cars that the French have negotiated?

Ambassador BROCK. No.

Mr. PEASE. No?

Ambassador BROCK. Absolutely not.

Mr. PEASE. How about the British?

Ambassador BROCK. No.

Mr. PEASE. How about the Germans?

Ambassador BROCK. Well?

Mr. PEASE. The Germans are pretty open now.

Ambassador BROCK. Yes, they are pretty open. I guess the German market as far as I know is open, and I think if the Japanese manufacturers were exercising restraint, that is probably about the same kind of thing that they have done with us.

Mr. PEASE. I think our responsibility in this committee is to look out for the U.S. national interest, and you are arguing, I guess, that in the long run the U.S. national interests would be better served without this kind of legislation, but it puzzles me that the French and the Italians and the British have all come to the conclusion that in terms of their national interests, it makes sense to have severe restrictions on the number of Japanese cars coming into their markets. How can they see it differently than we do?

Ambassador BROCK. I think they are wrong.

Mr. PEASE. Pardon me?

Ambassador BROCK. I think they are wrong, and I think the facts justify that statement, Congressman. What has happened to the dollar in the last 2 years with the change in U.S. policy?

And what has happened to the franc? The franc is much, much devalued in terms of the dollar. Why? Because people believe the United States is a healthier country with a healthier economy. It is getting its inflation under control, its interest rates are coming down. None of those things are happening in France. They are going to freeze themselves into an industrial base that is noncompetitive, if they stay with this policy. What is their future?

Secretary BALDRIGE. May I make another point on that subject?

We don't like some of the things going on here, no two ways about that. We would do them different.

Our trading system nobody has ever said is perfect, but what we are trying to do is keep it headed toward free trade as much as possible.

But the European Communities right now in their trade with the United States, the United States has an $11 billion surplus. We export $11 billion more to European Communities than we import from them.

Now, retaliation may be the wrong word. I would look at it in a different way. I don't think it would be direct retaliation on automobiles if this went through. It would give them a hunting license because we have taken this step on local content which is strict protectionism.

It would give them a hunting license on agricultural items, computers, and telecommunications and all the other things that make up that surplus.

Any time they wanted something protected, they would have a good excuse because we have taken this step. That is the way it would happen more than just direct retaliation on cars.

Mr. PEASE. Mr. Chairman, I will close by just asking the Ambassador whether there might not be one important other reason for the difficulty in our automobile restrictions which would cause the devaluation of the franc and the pound against the dollar.

I understand that the yen may have been devaluated against the dollar, surely the Japanese would not follow the same policy as the French and British.

Ambassador BROCK. You can't keep throwing my own words back at me; that is not fair.

I accept the point. You are right. I think it is not, obviously not the automobile policy that has caused the shift in the currency, but it is the combination of policies which that represents that causes them to question whether or not they have gotten their economies in the kind of shape for recovery that we have.

I think the evaluation of the international system is that the United States is doing some fundamentally right things. The right things are: we have inflation down by half; we have our interest rates down by about 35 percent and we have the prospect of renewed growth.

All of these things cumulate into the economic policy.

Mr. PEASE. Mr. Chairman, I appreciate the indulgence of the Chair. I will not ask any other questions, but I would just like to state for the record that I have exercised a great deal of will power not to comment on the overall economic future of our country and whether what has come to be known as Reaganomics will produce an upturn or not.

Ambassador BROCK. We will discuss it at a later time, I am sure.

Mr. FRENZEL. If the gentleman will yield, I will not discuss Tiponomics, just to be nice.

Chairman GIBBONS. I think the gentleman from Ohio did put his finger on a very important point. Do we want to emulate the French, Italians, British, or even the Japanese?

You know, let's just look at the big picture. Their economies are all going downhill, even the Japanese economy.

As I recall your most recent publication, Mr. Baldrige, the United States is now running a surplus in trade; as reflected by the strength of our dollar we have had a substantial surplus and have had ever since about 1977.

Ambassador BROCK. In current account, yes.

Chairman GIBBONS. That is the broadest measure of trade.

I can recall sitting in this room in 1970 when our international trade was running about $2 billion a month—exports and imports, and now it is running almost that much a day.

I can remember just in my short term on this committee where international trade was 4 percent of GNP. It is what now?

Ambassador BROCK. Twelve.

Secretary BALDRIGE. Twelve and a half.

Ambassador BROCK. I would have said something like nine possibly, but it is in that range. In terms of manufactured exports, it is 20 percent of all that we manufacture goes to export and one-third of all we produce on the farm.

Chairman GIBBONS. One-fifth of what we manufacture is manufactured because somebody wants it overseas.

Ambassador BROCK. That is right.

Chairman GIBBONS. The policy hasn't gone all bankrupt. We haven't done all that bad. Every now and then I look at ourselves, and it reminds me of the rather unusual Iranian demonstrators we witnessed on television last year when they were walking down the streets screaming "Death to the Americans," and flogging themselves with chains.

We love to flog ourselves verbally. We are not doing as well as we would like to; but when you add up all the facts and figures, we are going pretty well.

Now, we have two sick industries; we have steel—I have talked about that. But we also have automobiles. That industry is also sick. But if you go over Mr. Baldrige's figures—I haven't heard anybody challenge them—you will see that we are doing very well in capital goods, doing very well in agriculture. We are doing very well in services; we are doing very well in practically everything except automobiles, some consumer goods, and, of course, steel.

Now, what can we do to help those sick industries without penalizing other Americans? I guess that is the question.

Does this bill really help those two sick industries without penalizing other Americans? What do you think?

Ambassador BROCK. First of all, it penalizes other Americans; second, I don't see what it really does to deal with the fundamental problem that they have.

The Congressman from Pennsylvania made an eloquent point about the need for a policy over the last 20 years that would help us come to grips with this because this problem is not new; it has been coming for a long time. I fully accept and agree with his point.

This doesn't do that. That is our fundamental concern.

Mr. BAILEY. Mr. Chairman.

Chairman GIBBONS. Go right ahead.

Mr. BAILEY. May I comment at this point?

The difficulty with the steel industry and automobiles, as was commented on earlier, is they highlight what basic root causes there are. I think everybody up here has talked about the reason for this legislation being originated or even getting attention.

You can't segregate those industries as if somehow they are singled out for preferential treatment.

The arguments about recourse allocation and preferential treatment overseas could easily have said they were entitled to excessive protection. That is a perfectly valid argument to come back against the contention that somehow this bill seeks preferential treatment for these industries at this time.

Incidentally, I don't think we realize the extent to which steel is used in the modern economy. I don't represent very much basic steel at all contrary to what many may think.

There may be a lack of understanding in this room of the extent to which steel is used for construction, and defense purposes, and a multitude of things.

It is the basic fabric building block material in a modern industrial society. It is just not a case of some little old industry and a few workers we want to help out. It has huge implications with all kinds of applications for the stuff.

I know it is going to be making you sad that I am leaving this Congress. Of course, the Ambassador can do his job and leave me out. But do you know what plans are being made? My concern is what the chairman said, that is, the future of free enterprise.

I really believe that you gentlemen are right when you say that this free enterprise model is what the world needs. The real question becomes, what you are doing and whether or not congressional policy or our policy is going to protect it.

Do we keep ourselves big and strong and brawny and change the policy sometimes and use our strength, or do we sit and fritter away industries subject to targeting from overseas and we don't have the strength to compete because somebody thinks we can sell services ad infinitum.

That, Mr. Secretary, is the real question and I would raise two questions in that regard.

Chairman GIBBONS. Would the gentleman yield?

Mr. BAILEY. Yes.

Chairman GIBBONS. There is no balance. There is no evidence the automobile industry has been targeted, dumped upon, or countervailed against.

There is no evidence that that has happened.

Mr. BAILEY. Mr. Chairman, if I could get back to my question, we have debated a number of different times before this committee everything from industrial practices to preferential treatment in Japan. I tried to draw some analogies to the historical use of tax policy, import restrictions, financial policies, and I had a great deal of agreement. I brought up two or three times with Mr. Brock the issue of capital incentive industries at large. We have not just two sick industries, incidentally. We have serious problems in this Nation's economy, serious investment patterns that affect literally all of our capital incentive industries.

They are too significant, the evidence of these things, to ignore.

Chairman GIBBONS. I hate to get into a debate with you, but the figures published by the Department of Commerce show we have a $40 billion surplus in the export of capital goods, not just total exports. It is surplus of exports over imports in capital goods.

Mr. BAILEY. Mr. Chairman, I will point up two things and use the things Mr. Brock has said if you will allow me to finish.

Chairman GIBBONS. Certainly.

Mr. BAILEY. Thank you. I think these highlight the concerns that someone like myself have. They have to do with trends.

Mr. Brock nodded in agreement. Maybe he would elucidate on machine tools. You know some of the cases I am talking about in that area.

You are one of the ones that brought it up and it was going to be one of my questions. I would like to see evaluation of antitrust policy and the implications for international trade, particularly with Japanese marketing policies.

I would like to hear suggestions; I would love to make a lot of them. I am interested in preserving this free enterprise here. When you look at the American industry that is troubled, particularly the ones that require the most concentrated form or highest long-term capital investment, I will give you some more ominous trends.

Let's talk about the nuclear supply industry.

You know exactly what I am saying. Let's talk about the role of foreign governments in financing capital incentive projects and processes in industry.

You know exactly what I am getting at, Mr. Secretary. You know what I mean.

We can talk about the French. I know you have this concern, because we all want to preserve this form of free enterprise. All of us believe and know that when it gets to the bottom line, and some day this world breathes free and those creaky-planned economies hopefully fall by the way without a nuclear war intervening in the meantime, that this form of government and this form of free enterprise will survive.

That is a dream of mine; it is of yours, too, isn't it?

How are we going to help it along? Trade wars from state capitalism, countries like Japan that will come in, and I say targeting, Mr. Chairman, I don't necessarily mean that they come in on day "X" and decide and do it.

They have done it in cases, but that they will come in and drive our automobile industry out of existence.

You talk about business practices that were the Japanese within the confines of our political boundaries, given our antitrust philosophy, that they would have been prevented from doing those things. Now the challenge before us is, how we swing our economic weight as a nation to build this free enterprise model for the good of mankind, right?

How are you going to do it? What are you going to do? Do you have some ideas to do something with the role of Government in financing? We didn't talk about it very often in this Congress. We don't talk about it much in this committee.

Secretary **Baldrige**. If you give me your question, is the question like what are we going to do about the free enterprise system?

Mr. **Bailey**. No, just Government financing.

Secretary **Baldrige**. Let's just take Government financing. In this country one of the main reasons for the problems that the capital intensive industries have is the increase in inflation that has taken place over 15 years.

It is not a political statement; it is a question of fact. You cannot sell equity now as you used to be able to because the ratios are too low. You can't sell to the extent they need to expand. You can't go in long-term debt because inflation drove the prices up too high. So the capital incentive industries that need that for a new furnace that is supposed to last for 30 years, they are trying to finance that right now with short-term debt and it just won't work. But if you say it is not really the idea that the U.S. Government should step in and finance those themselves; that won't work at all. The Government has to get the inflation rate down and get it——

Mr. **Bailey**. If I might reclaim my time, Mr. Chairman.

Mr. Secretary, thank you very much. Inflation as an explanation for the investment difficulties in capital intensive industries, as I am sure with your excellent experience and education you know, is not an adequate answer because the roots, Mr. Secretary, run much deeper and you know that. Don't you?

Secretary **Baldrige**. No, I don't know.

Mr. **Bailey**. You don't?

Secretary **Baldrige**. I know inflation is the chief cause of the problems we are having in financing capital intensive industries.

Mr. **Bailey**. Today.

Secretary **Baldrige**. Because any capital intensive industry has to finance long term. The blast furnace and so forth, over 30 years. You get long-term rates up because of inflation, then they are driven to short term.

Mr. **Bailey**. I want to tell you that the most modern facility we are talking about, if you want to talk about blast facilities, was built in 1957 and we had this ravaging inflation so you ought to do some homework.

Let me ask you a very brief question this way.

Secretary **Baldrige**. 1957?

Mr. **Bailey**. As far as Government involvement in financial arrangements is concerned, is Government financing or subsidization of an interest agreement on a capital project, is that a violation of GATT?

Is that a violation of the subsidization?

Ambassador **Brock**. Say that again.

Mr. **Bailey**. If the Government of France steps in and finances at a subsidized rate a financial package and provides some of the credit support for a large capital project, say, steam turbines or a nuclear powerplant, is that a GATT violation?

Ambassador **Brock**. Yes.

Secretary **Baldrige**. Yes.

Mr. **Bailey**. Is that happening?

Secretary **Baldrige**. Yes, we have cases against France on countervailing now in the steel industry against France.

Mr. **Bailey**. What have we done, are you prosecuting those?

Secretary **Baldrige**. We certainly are. We have 70 people in the Commerce Department that have done nothing since the first of the year but work on those steel cases.

They have gone to every steel company in Europe that is under the cases. They have checked up on them. We have been through the preliminary and financial determination, and those cases will be—actually they will be decided by the ITC if there is final determination of injury, in October.

Mr. **Bailey**. If anything shows what energy and enthusiasm and dispatch with which you have enforced those laws serves as a model to American industry and to our private industry in this country of the confidence and respect that your administration has for the law, that certainly does.

Ambassador **Brock**. Congressman, let me speak on this issue because that, I think, is unwarranted.

We operated for several years under the trigger price mechanism negotiated by the previous administration and we held to that agreement and last year our trading partners began to break away from it.

We had the surge in August, the Commerce Department began its investigations almost immediately. We are prepared to file cases within 60 days of the beginning of that investigation which is fast time for any government administration.

The industry saw fit to file its own cases. We followed the letter of the congressional law in pursuing both the filing of subsidies and injury. We went through the legitimate process which we have to do and I should have said in a qualified answer to your statement, the actions you describe are not a violation of the GATT unless they result in injury.

So we have to, if we are going to comply with it——

Mr. **Bailey**. I know all that went on, in fact you and I talked privately about what went on in these cases.

And I must say that in terms of the attitude of the Government, I guess I just do not agree with you that they have really been enthusiastically enforced at all.

Secretary **Baldrige**. Congressman, can I point out something to you about those cases?

Mr. **Bailey**. Do you mind if I close my hypothetical question and then I would be happy to let you go on, I am not trying to cut you off.

France was involved in an arrangement, supposedly in trying to finance deals on some nuclear powerplants to Brazil, I think.

One of the finance issues talked about that I read—I don't know how accurate it was—it was something like 2 or 3 percent financing.

I don't think the deal ever went through but had it gone through, would that have been a violation of GATT?

Ambassador **Brock**. Yes, it is an export violation.

Mr. **Bailey**. It would have been?

Ambassador **Brock**. Yes, we have—Treasury spent a great deal of time and effort and made a lot of progress in moving the credit arrangement out where those practices do not occur.

The problem is in aircraft and nuclear and we are negotiating now, beyond the standstill agreement, to complete the program.

But we have made a lot of progress in reducing that subsidy.

Mr. **Bailey**. Mr. Secretary, I had interrupted you.

Secretary **Baldrige**. Mr. Congressman, first, I was taking your kind words about me in the sense that they were meant, but Bill Brock evidently thought they were sarcastic, so I——

Mr. **Bailey**. No, no.

Secretary **Baldrige**. So I thought I would explain this. The Commerce Department brought cases, self-initiated them in December. We told the U.S. industry that if they wanted to bring their own cases as soon as they thought they could prove injury, as well as subsidy—because you have to prove both—we would be glad to get to work on them.

They did not do that until January. Now, January of this year, until our preliminary finding of subsidies was 5 months, 70 people fanned out all over Europe, checking on allegations, going into the accounting and seeing this firsthand because, Congressman, we are going to be sued by both sides, no matter what happens, we will be sued by the United States and sued by the Europeans unless there is settlement of the cases.

We tried to be sure we were right. We did that for 5 months. I do not think the Federal courts, if this was their responsibility, could have done it in four times that amount of time.

I don't think any other body that you know of could have done it in any less time.

Mr. **Bailey**. Well, we disagree.

Secretary **Baldrige**. The steel people would agree with me on that.

Mr. **Bailey**. I don't know about that. I know some of the pleas that were made in some of your offices and I know some of the threats made.

I was very intimately involved in some of the consultations about the advice of what to do. Very, very close to it.

I know the politics of what went on in terms of trying to get something done with those cases. Most people, I must tell you, they may not be right, but their feeling was they had to kick you in the behind. Now that might not be right and I apologize for them if they are misleading us.

But that was their interpretation that they were not getting cooperation. As a matter of fact, I met with some Europeans on it who said they were talking with you folks and trying to encourage you not to proceed and not to go ahead.

And for other reasons, you kind of——

Secretary **Baldrige**. Congressman, that could not be more wrong.

Mr. **Bailey**. Is that wrong?

Secretary **Baldrige**. That is dead wrong. We told the industry and they will back me up on this, that as soon as they could prove injury, start the cases.

They did not do that until January, we took 5 months to get the preliminary determination. I don't know of any other way it could have been done any faster and still had it right.

Mr. **Bailey**. Can you cooperate with them on gathering information and providing statistics and information?

Secretary **Baldrige**. What do you call having 70 people in the Commerce Department?

Mr. **Bailey**. You tell me. They just told me you were not doing that job. Were you doing that job?

Secretary **Baldrige**. I will tell you what, I have said yes, I mean yes, and if you got any other doubts, why don't you just ask the chairman of United States Steel, Bethlehem.

Mr. **Bailey**. I am going to.

Secretary **Baldrige**. J&L, Republic, ask them all, take a poll.

Mr. **Bailey**. I already have and I intend to do some more. I will find out a lot more about it.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you.

Mr. Frenzel.

Mr. **Frenzel**. I think our time has been expired by our colleague.

In the first place, I would like to ask the Secretary of Commerce if he would provide a list for us for the record of the foreign-owned firms in this country that are likely not to be able to operate under this law, and, therefore, will have to close and some indication of the number of jobs involved and the amount of investment that will be terminated or allowed to sit idle.

[The following answer was subsequently received:]

We believe the following investment will be terminated:

Honda.—Marysville, Ohio assembly plant will employ 2,000 people at an investment of over $200 million.

Nissan.—Smyrna, Tenn., assembly plant will employ 2,200 people at an investment of over $300 million.

In addition, Volkswagen's U.S. operations will be put at risk. Total VW employment in the United States is around 8,000 workers.

Mr. **Frenzel**. I would like to complain to Ambassador Brock when he said that the voluntary automobile agreement with Japan, which he cannot put "voluntary" in quotation marks, but I can, did not raise the price of automobiles in the United States.

You know darn well it did. It first raised them in the price of Japanese models that were upgraded because they had a limit on what they could sell in this country and they also tended to allow, that increase allowed U.S. machinery to go higher, too.

So I think we paid a price there for protectionism, voluntary protectionism, which we inflicted on Japan.

Do you have a comment?

Ambassador **Brock**. I accept the argument they shifted into the higher price range which was an absolutely natural and predictable consequence which we did predict at that time.

I don't accept that it has increased the price of American cars because I think you will find that American cars in the low range are now substantially lower priced than the Japanese models that they had to compete with some time ago.

Mr. **Frenzel**. I am talking about all the models through all the ranges.

Ambassador **Brock**. Possibly, but——

Mr. **Frenzel**. When the competition goes up, you go up.

Ambassador **Brock**. The competition moved up in model range——

Mr. **Frenzel**. I learned that from Secretary McNamar, he says you cannot repeal the laws of economics.

Ambassador **Brock**. I generally agree with that. I don't think you can make the case that the cuts were made anywhere near the domestic content legislation level.

Mr. **Frenzel** I agree, but we paid a price for a small protectionism adventure and we will pay just a horrifying and appalling price if we go ahead with this protection.

Ambassador **Brock**. You always pay a price for protectionism.

Mr. **Frenzel**. Mr. Pease asked you a question, he said nobody is going to bother us if we apply this little bit of domestic content, and you said, well, it would apply elsewhere.

Let's take the case of corn gluten flour. What do you think the European Community would do if we passed the domestic content bill? Do you think they would talk about domestic content in feed for livestock?

What is the size of that business?

Ambassador **Brock**. We are doing about half a billion dollars worth of business in corn gluten feeds, $4 billion in soybeans, both of which would be in severe jeopardy if we were to take this action.

Mr. **Frenzel**. Particularly with the imminent Spanish secession to the European Community.

Ambassador **Brock**. That is correct. They are under great pressure to take action now.

Mr. **Frenzel**. Of course, the European Community has a severe imbalance with us and they would feel, just as Mr. Bailey would feel, that they are being done out of our market because of this terrible imbalance.

Will they not?

Ambassador **Brock**. Yes.

Mr. **Frenzel**. They are asking us every day if we cannot buy more things.

Ambassador **Brock**. Yes.

Mr. **Frenzel**. If we set this bad example for them, what is your opinion of what they are going to do?

Ambassador **Brock**. They will respond in kind and our exports will be measurably dampened.

Mr. **Frenzel**. I want to talk about an earlier statement by one of the questioners about the restrictions on automobiles in Japan, simply invite the committee's attention to the Jones report of our Japan task force of a couple years ago where we found how vigorously the American automobile manufacturers were promoting their cars in Japan.

They were still selling cars that didn't fit on the streets, they had the steering wheel on the wrong side, they had to be reworked when they got to Japan, they were made comfortable in the front seat for American drivers when they knew Japanese who have enough affluence to have an American car were going to sit in the back seat where it wasn't very comfortable, and they could not see out.

Our inability to market in Japan was partly the fault of Japanese standards which have been reduced substantially, but it was mainly because we didn't choose to operate in that market.

We did not have competitive cars for that market and so we did not operate there.

Finally, I want to talk about the suggestion of Mr. Pease why don't we do like the French, British, and Italians are doing, and of course, the answer is that over at least my economic lifetime, we have.

We have tried in this country to subsidize those industries which are not competitive. Now in my judgment—I am one of the oldtime free marketers—I would prefer not to have subsidies, but if we were to do it, why follow the European tradition?

Why not do it the way the Japanese do, they bet on an industry of the future that is growing and providing jobs. Why don't we do what the Europeans are doing who are now in a 10-times worse recession than we with no prospects of coming out?

Any of you like to follow the European model there?

Ambassador **Brock**. No, sir.

Mr. **Frenzel**. A final question, earlier I suggested that the whole bill revolves around the Secretary of Transportation which is one of the problems with it. I assume you are the designated Government witnesses for this bill and that the Department of Transportation does not want to appear and if it were subpenaed, it would not present a different statement than you are presenting; is this to the best of your knowledge or will you simply respond to that any way you want?

Ambassador **Brock**. I think they will be on the next panel, Congressman.

Mr. **Frenzel**. Oh, they are going to be. You will let them speak for themselves?

Ambassador **Brock**. Of course.

Secretary **Baldrige**. They are working with the engineers now, I think.

Mr. **Frenzel**. OK.

Well, I thank all of you for your testimony. I think it has been an enlightening 4 hours and your patience is appreciated.

Mr. **Brodhead**. Mr. Chairman.

Chairman **Gibbons**. Yes.

Mr. **Brodhead**. Mr. Frenzel, just as he was inspired by Mr. Bailey, he has inspired me. I will try to be very brief because I know everyone wants to go.

It certainly strains credulity to believe the European Community is going to be greatly upset by this action which we all agree is not directed against them, will not have impact on them and in particular, it seems hard to manage how they can complain about us taking an action which they themselves have taken.

As a matter of fact, Belgium, France, Germany, Italy, Spain, and the United Kingdom already have very, very substantial limits on the imports of Japanese automobiles.

How can they object to us doing the same thing they are doing when it doesn't hurt them at all? I think that is just a red herring.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you.

Thank you, gentlemen. I have a number of questions in writing and I will submit them for the record.

[The questions and answers follow:]

The Secretary of Commerce,
Washington, D.C., September 30, 1982.

Hon. Sam M. Gibbons,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

Dear Sam: Thank you for your letter requesting additional information on H.R. 5133. The answers to your questions are enclosed. I have also provided a response to a question raised by Mr. Frenzel during my testimony that was not fully answered at the time.

The Administration appreciates your efforts to provide a full and fair hearing on the local content legislation. Your Subcommittee has provided a valuable service and I appreciate the opportunity to testify.

Please let me know if we can be of further assistance.

Sincerely,

Malcolm Baldrige,
Secretary of Commerce.

Enclosures.

Question. In the view of the Administration, is the Ottinger substitute worse than the previous version?

Answer. While proponents argue that the revised bill is more moderate an examination of both bills in depth, quickly shows that their effects are equally undesirable. They both violate the General Agreement of Tariffs and Trade; they both invite retaliation; they both have a modest jobs effect; neither assists the industry's recovery; they both ask other sectors of the U.S. economy to take on the pain of the auto sector; they both invite other industries to seek long-term protection; and they both increase government regulations.

In short, they are both local content bills and we remain adamantly opposed to this concept.

Question. Given your strong opposition to local content legislation, how do you plan to address the U.S. auto industry's problems?

Answer. As we have stated many times, the industry's current difficulties stem in large part from the problems of the overall economy. Car sales are down, and we see little inprovement until consumers sense that interest rates and inflation will continue at reduced levels. We expect general economic recovery to get underway in the autumn, providing the industry with an opportunity to increase its sales.

We are also actively working to reduce the regulatory burden on the industry. Final action has been taken on 22 regulations affecting the auto industry, decisions are pending on seven more, and action on five others is the subject of preliminary notice or hearings.

We have supported tax programs that have directly benefited the industry, and we continue to support changes in the Clean Air Act which will provide additional relief from overly harsh requirements.

The Administration also supports S. 2036, the Training for Jobs Act, which provides Federal funds to the States on a matching basis to run retraining programs for individuals who have been unemployed 15 weeks or more.

Question. Can the U.S. auto industry survive without a domestic content law?

Answer. We believe it can. The U.S. companies are investing massive amounts of capital to address their competitive problems, and labor and management are working together to improve productivity and hold down costs. These efforts will be hindered by an law which insulates the U.S. industry from foreign competition.

Question. Has the Commerce Department been successful in promoting the sale of U.S. auto parts to Japan per our agreement of several years ago?

Answer The U.S. and Japanese governments met in Tokyo on December 8, 1981, to discuss the progress made on the Japanese commitment to increase purchases of U.S. auto parts.

At that time, the United States expressed deep concern about the growing imbalance in U.S.-Japanese auto parts trade and, specifically, about the failure of Japan to meet the $300 million goal for purchase of U.S. auto parts in 1981. (U.S. export data indicate that auto parts shipments to Japan in 1981 totaled roughly $119 million.)

The Japanese stated that the $300 million figure had never been a commitment, but simply a forecast; and the imposition of the Japanse restraints on auto exports made that no longer realistic.

At the same time, Japanese representatives indicated that it would not be possible to establish a forecast for 1982 imports. However, the Japanese did agree to work toward the steady increase in purchases of U.S. parts in 1982.

U.S. export data indicate that auto parts shipments to Japan for January to July 1982, totaled almost $75 million, an increase of about 17 percent over the same period in 1981.

The Department is continuing its efforts to help stimulate U.S. exports of auto parts to Japan, and to encourage increased sales of U.S.-made auto parts in the U.S. aftermarket for Japanese vehicles. As part of this effort we will be working with consulting firms and auto parts associations to identify U.S.-made auto parts that are competitive in the export market and the U.S. aftermarket.

The second follow-up meeting to the Japanese buying and selling missions is tentatively planned for late 1982 or early 1983.

Question. How would the bill impact on the joint ventures currently underway between several U.S. auto makers and Japanese manufacturers?

Answer. This would depend on each manufacturer's U.S. content percentage as determined by the formula in the bill. It is our current estimate that existing joint ventures would not be affected. They are not that significant when measured against each company's overall volume. The bill probably will limit future joint venture possibilities.

Question. Would this bill encourage Japanese investment?

Answer. We do not believe it will encourage Japanese investment in the U.S. We do not believe the Japanese will establish U.S. plants. To do so would disrupt the extremely efficient production base in Japan in order to construct vehicles which do not have the sales volume to economically support an assembly plant. Why should they begin producing in a country where an entirely new manufacturing system will have to be constructed? Why should they increase their cost significantly to add capacity they do not need?

Question. It would appear to me that some jobs that have been lost in the automobile industry will never be replaced by human workers. Do your estimates for increases in employment in the U.S. auto industry take into account the types of structural changes in production—use of robots, for instance—that will be necessary for the U.S. industry to compete successfully with our trading partners in the future?

Answer. Our estimates on employment were based on studies done by the Transportation Systems Center in Cambridge, Mass. They have concluded that by 1985–1986 (the time frame examined in our study), the impact of plant moderization on overall industry imployment will not significantly change the labor output ratios currently existing in the industry. This is primarily due to two factors. The first is the efficiency improvements which have already been made. While we can measure that the current labor/output ratio is, it is very speculative to determine what it will be in a good sales year when the new efficiencies will be tested.

The second factor is the pace of modernization. The physical process of designing, procuring and utilizing new machines is a very lengthy one and means that significant changes in over labor/output ratios may not take place until the mid-late 1980's. The ratios utilized in our study were 14.8 units/manyear for direct employment and 6.0 units per manyear for total employment.

THE UNITED STATES TRADE REPRESENTATIVE,
Washington, D.C., September 30, 1982.

Hon. SAM M. GIBBONS,
Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR SAM: Thank you for your letter of September 23, in which you posed some supplemental questions relating to my testimony on H.R. 5133 before your subcommittee on Trade. My responses to these questions are attached for inclusion in the hearing record.

I believe that we mutually share a single view as to the great damage to the United States and world economies that would result from enactment of domestic content legislation. I appreciate your complimentary remarks regarding my own testimony; however your leadership in the Congress in bringing to light the dangers inherent in H.R 5133 through full and fair hearings is, itself, the more significant contribution.

Very truly yours,

WILLIAM E. BROCK.

Enclosure.

Question 1. "What are the latest steps taken by the Administration for achieving fair market access to Japanese markets?"

On May 28 Prime Minister Suzuki issued a statement with an unusually strong and direct appeal to the Japanese people to welcome foreign goods and investment concurrent with the announcement of a second in a series of initiatives to address the trade problem. After the publication of the May 28 package, Ambassador Brock requested that the Japanese Government work with the U.S. Government for the purpose of initiating a continuing program designed to resolve difficulties that may arise in implementing the package. During the first week of August, a sub-group of the U.S.-Japan Trade Subcommittee inaugurated a series of visits to Tokyo. Those visits, which will be carried out regularly, have the following objectives: (1) to clarify the Japanese Government's measures and plans for implementation; (2) to bring to the attention of the appropriate Japanese Government Ministries and/or the Office of the Trade Ombudsman, and to seek resolution of, specific access problems experienced by American businessmen; and (3) to sustain momentum toward a more open Japanese economy by addressing issues unresolved or omitted from the package.

During their first visit in August, the U.S. Delegation received the Government of Japan's response to an extensive list of questions on the implementation of the May 28 package. Analysis of these response revealed substantial progress in such areas as customs procedures, easing of access to the insurance market, and standards issues. However, the May package has produced no new opening of the Japanese market, nor completely resolved any major problem. A subsequent trip to Japan to discuss implementation of the May 28 package was made last week (September 20–24) by an interagency delegation, with another trip scheduled for next month.

When the best efforts of our bilateral discussions fail to overcome the differences between our two positions and to resolve outstanding issues, the Administration has determined that the U.S. should avail itself of the remedies afforded for dispute settlement under the General Agreement on Tariffs and Trade and the various codes negotiated in the Tokyo Round of multilateral trade negotiations. We have recently taken action to pursue a certification complaint on baseball bats under the Standards Code and have informed the Japanese of our intention to move into formal dispute settlement on leather.

Question 2. "What is the current tariff policy and rates of duty on imported Japanese autos?"

The United States duty on passenger cars, TSUS 692.02, is 2.8 percent, ad valorem. As a result of the multilateral trade negotiations, this tariff is being staged down from its 1980 rate of 3.0 percent to 2.5 percent.

Question 3. "What GATT sanctions or retaliatory trade restrictions would Japan be entitled to if the U.S. enacted a local content law?"

If the U.S. enacted local content law, which was inconsistent with Articles III and XI of GATT, the Japanese could invoke the dispute settlement provisions of Article XXIII of that agreement. Although the procedures under the article start with bilateral consultations, it provides that they can quickly progress to formal consideration of the question by a panel. The panel could find that the U.S. action is in violation of provisions of the agreement, take the position that the action should be terminated, and make such other recommendation as it considers appropriate.

Any such panel report is likely to be adopted by the GATT Council, which would give it formal status. If its recommendations should not be complied with, the Contracting Parties, acting jointly, may authorize Japan to suspend the application to the U.S. of such concessions or other obligations under GATT as they determine to be appropriate in the circumstances. This final retaliatory provision has rarely been formally invoked. However, the finding of violation by a panel and the Council would have serious repercussions on the credibility of the U.S. in GATT, particularly in relation to the numerous U.S. formal complaints now being considered within that body and U.S. initiatives in the context of the Ministerial to tighten the dispute settlement process. Moreover, it could weaken greatly our ability to negotiate with Japan for the relaxation of its restrictions on our exports to that country.

Question 4. "Will the market liberalization procedures announced by Japan be set back?"

As I noted in my prepared statement, no one can accurately predict Japan's precise reaction to enactment of this legislation. Japan is the largest market for U.S. agricultural exports and, even without formal retaliation, could direct many of its purchases to other world suppliers. Certainly, further U.S. efforts to seek additional market access for American exports to Japan would be futile after the enactment of such legislation. But more importantly, on a broader scale, the negative precedent set by the United States in blatantly violating its international commitments could lead to the introduction of similar measures by our major trading partners thereby unraveling much of the progress made in recent decades in liberalizing the international trading system.

Question 5. "Will enactment encourage or discourage Japanese and other foreign investment in the U.S.?"

Although this question is best answered by the foreign auto manufacturers, it is our view that Japanese manufacturers will not totally disrupt their highly integrated and efficient manufacturing base in Japan to meet the proposed U.S. domestic content requirements. What new investment that is likely to be made in this country would be in highly automated parts and auto assembly plants which provide maximum value added and relatively few new jobs.

Question 6. "In your view, how would the bill affect U.S. auto makers? Would the auto makers be put at a competitive disadvantage in the market because they would be prohibited from seeking the best products at the lowest cost because foreign sourcing would be curtailed?"

For the reason that you stated, domestic manufacturers would indeed be placed at a competitive disadvantage with respect to foreign manufacturers. Domestic content requirements, therefore, can not be a temporary measure but are self perpetuating since they distort the structure of the domestic industry away from efficient operation.

Question 7. "Would you support temporarily raising the duty for imported cars (currently at 2.8 percent)?"

I would be opposed to temporarily raising the import duty on automobiles. Raising the duty would nullify our GATT bindings and require us to offer compensation on about 15 billion dollars worth of trade. Since, in fact, we could not find enough in duties on other imported products to compensate our trading partners, we would most likely suffer retaliation in terms of higher duties on our exports.

Question 8. "Would the U.S. position be greatly weakened as we approach our November GATT ministerial meeting in Geneva? (i.e., high technology, services, and investment)"

H.R. 5133 is directly contrary to the requirements of GATT Articles III and XI. For the United States with the world's strongest economy to blatantly violate the rules of international trade is to destroy these rules. What damage to the U.S. trading position that wasn't done by foreign retaliation would be accomplished by foreign emulation of our actions. Certainly, enactment of legislation so violative of our international obligations would undermine the current drive of the United States to open foreign markets more fully. U.S. initiatives for the GATT Ministerial meeting in Geneva, particularly in services, high technology, investment and agriculture, aimed at opening and improving the trading system would be doomed to failure.

Question 9. "What is the Administration doing about foreign local content laws which are violative of the GATT? Has the Administration sought the reduction or elimination of other tariff and non-tariff barriers maintained by our trading partners in the automobile sector?"

We are taking a host of coordinated actions which are intended to reduce the use of performance requirements including local content requirements in the auto sector.

We are developing a comprehensive inventory of the use of these measures by foreign governments and identifying those measures (and the countries where they are used) that require expeditious action. We have taken Canada to the GATT concerning the performance requirements imposed by the Foreign Investment Review Agency (FIRA). We have agreed on the terms of reference and are well along in the Panel formation. We expect formal presentation by each side to take place some time in November. In addition the President has requested that the USITC do a study on the effects of performance requirements.

We intend to take future GATT actions, where appropriate, against other nations whose use of performance requirements are damaging to U.S. exports.

In the long run, we hope to negotiate new international disciplines governing the use of these measures. Our bilateral investment treaties have a section dealing with the use of performance requirements. We now have a signed agreement with Egypt which is awaiting Senate ratification. We have negotiations in process with several other developing nations. We hope these efforts will help focus attention on and control the use of performance requirements.

However, what is really needed is a more detailed multilateral understanding governing the use of performance requirements. To this end we hope at the upcoming GATT Ministerial to launch this initiative through the adoption of a work program.

Question 10. "What is the status of existing Japanese voluntary export restraint on autos in terms of possible renewal next year, i.e., have any talks taken place with the Japanese on this subject, have they given any indication of what their export plans may be after the restraint expires, and what would be the Administration's position on a renewal?"

As you know, the voluntary restraint on auto exports to the United States, implemented by the Japanese Government in the spring of 1981, is now in its second year. In March of this year, the Japanese Government announced that exports for the second year of the restraint program would be frozen at the same level as the first year, 1,680,000 passenger cars.

While the Japanese measures have been working, the domestic automotive industry continues to suffer because our economy has not yet recovered from the current recession. The Administration has made significant strides in easing the regulatory burden on our automakers, and management and labor have been working together to produce high quality cars that are competitively priced. The effects of these achievements will become increasingly evident as the U.S. economy improves—the real prerequisite for full recovery of the automotive industry. In the meantime, however, it is my personal view that continued export restraint by the Japanese is likely to be needed to ease the burden on the industry.

Since there are six months remaining in the current restraint period, we have not yet had consultations with the Government of Japan regarding a third year of restraint, nor have they given us any additional indication as to their plans after March 31, 1983.

THE DEPUTY SECRETARY OF THE TREASURY,
Washington, D.C., October 18, 1982.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade,
Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed are the answers to the questions relating to H.R. 5133 which you requested for the record. I hope you found Under Secretary Sprinkel's testimony on the dollar/yen relationship helpful. Marc Leland will be commenting directly on the Caterpillar study shortly.

Thank you for providing the Administration the opportunity to present its views on this legislation, which you have correctly characterized as the worst trade legislation to be seriously considered in 50 years. Please let me know if I can be of further assistance.

Sincerely,

R. T. MCNAMAR.

Enclosures

Question. What is the role of U.S. tax policy in the production costs differential between Japanese and U.S. autos?

Answer. Considerable caution is necessary in interpreting the effect of tax policy on production costs in the auto industry or any other single industry, particularly if conclusions are to be drawn about international competitiveness and trade. It is not sufficient simply to compare the dollars of taxes paid by the labor and capital producing an automobile in the United States with the dollars of taxes, converted from yen at current exchange rates, paid by labor and capital in Japan. Attention must be paid to the following questions. Is the tax more heavily imposed on one industry or group of industries than another, or is it a general tax? Is the tax burden falling more heavily on one factor of production than another? Are some products or factors more sensitive to taxation than others? What is the impact of exchange rate adjustments in equalizing costs of production among countries?

The primary impact of taxation and government spending on the private sector is to reduce private sector output and, in particular, the share of private sector output available after tax to consumers and private sector investors. The effect on competitiveness and trade is somewhat more complex.

First, higher taxes in the United States may not result dollar-for-dollar in higher prices because they are partly absorbed by labor and capital in the form of lower after-tax earnings. This does reduce domestic output, however, but it does so across the whole private sector.

Second, even if higher taxes are not absorbed fully by workers, higher taxes in the United States need not result automatically in a wider merchandise trade deficit overall. For example, if there is a uniform increase in U.S. taxes on all factors and industries, and wage and capital costs rise, this will affect the costs of non-trade goods, U.S. export goods, and the cost of import-competing goods of which automobiles are only one example. Exports would fall, and imports could temporarily rise. The trade balance could worsen at first. However, these changes would lead to a depreciation of the dollar. The increased price of foreign currencies would tend to restore the balance of trade, although perhaps at a lower level of both imports and exports.

Third, there may be differential impacts across industries. As mentioned, some industries or productive factors could contract more than others in the presence of a uniform tax increase, or there may be differential tax treatment across factors or industries. Thus, tax policy's effect on a particular U.S. industry depends greatly on how heavily it and factors it uses intensively are taxed compared to other domestic industries or factors. Taxes or tax changes could adversely affect the competitiveness of U.S. automobiles if Japan taxes its automobiles less than other sectors of the Japanese economy or if the United States imposes relaitvely high taxes on the automobile industry compared to other U.S. industries.

While it is difficult to make precise estimates, it is not clear, as far as taxes on labor and capital income are concerned, that there are significant relative Japanese tax preferences for automobiles per se compared to other Japanese manufacturing, nor significant relative penalties for the automobile industry in the United States. Both Japan and the United States tax the agricultural sector relatively lightly and the manufacturing sector relatively heavily.

In fact, the tax code is not uniform across incomes and industries. For example, the tax code places differential burdens on labor according to differences in nominal income. It tends to affect workers differentially according to differences in levels of skill, education, and real income, according to whether one or both spouses work, even according to cost-of-living and income differences related to geography. Japan's larger deductions and lower real wages may leave highly skilled workers in Japan somewhat lower in the tax brackets than in the United States. Thus, insofar as the automobile industry is disproportionately a high skill, high wage industry, there could be differential tax impacts on labor income.

Question. Some studies I have heard of indicated that the tax on labor alone (such as payroll and Social Security taxes) give the Japanese an advantage of $300 to $400 a car. Comment?

Answer. Again it is not sufficient simply to compare the dollars of taxes paid by the labor and/or capital producing an automobile in the United States with the dollars of taxes, converted from yen at current exchange rates, paid by labor and/or capital producing an automobile in Japan. If the intent is to show a trade advantage, the issue is whether the Japanese automobile industry receives tax benefits relative to other Japanese industries, or whether the U.S. automobile industry is penalized compared to other U.S. industries. It would be difficult to make precise estimates in that area.

Average personal income tax rates are higher in the United States than in Japan. This tax burden would have as primary impact a reduction in the size of the U.S. private sector as a whole, rather than a particular impact on one industry or on traded vs. non-traded goods.

Sales of domestically produced autos have fallen by over 3.5 million units from 9.2 million in 1978 to a 5.6 million annual rate so far this year. During this period, sales of imports have risen by only 200,000 units from 2.0 million in 1978 to a 2.2 million annual rate in the first nine months of 1982. This is a clear indication that domestic auto production, like other private sector activity is a function primarily of the state of the U.S. economy, which has been adversely impacted by high government spending and taxes, regulation, inflation, and interest rates.

Question. What feasible remedies to the tax code are possible?

Answer. It would be impossible to restrict the discussion to the tax code or to the auto industry alone. Government spending restraint is needed to reduce the burden on the tax system, to reduce the diversion of manpower and material from private sector to public sector use, and to permit the shift of more manpower and material to modernization of the industrial sector. However, for any given level of Federal spending, tax rates on incremental saving, investment, and work effort should be kept as low as possible. This would minimize the dead weight social cost and the tendency to leave resources idle or to divert them to the underground economy, and to reduce the tendency for the "fiscal dividend" from inflation to lead to higher Federal spending. In particular, as far as income from labor is concerned, marginal income tax rates and payroll tax rates should be kept as low as is consistent with financing necessary Federal programs. Every effort should be made to avoid placing a higher burden from either source on incremental earnings of labor. This would involve retention of the third-year tax cut and indexing, as well as being cautious concerning increases in payroll tax rates, which are already scheduled to rise substantially in 1985, 1986, and 1990. Furthermore, substantial steps have been taken under ACRS, as modified by TEFRA, to reduce the adverse impact of inflation on capital formation. Continued progress in reducing inflation remains essential, however.

Question. Has the new ERTA accelerated depreciation schedules and investment tax credits assisted the auto industry at all?

Answer. Yes. The Economic Recovery Tax Act of 1981 (ERTA) increased the total value of depreciation deductions and investment credits claimable by the automobile industry on the average new investment.

The investment credit rates claimable pre-ERTA was 3.33 percent on 3-year equipment, 6.67 percent on 5-year equipment, and 10 percent on 7-year equipment. The accelerated cost recovery system allowed a 6 percent credit on 3-year equipment and a 10 percent credit on equipment with a life of 5 years or more. In addition, machinery and equipment depreciation schedules were simplified and generally accelerated into categories of 3-, 5-, and 10-year lives. The result was a substantial reduction in the overall effective corporate tax rate applied to new investments in the automobile industry.

Using the observed investment pattern of the motor vehicle industry, effective tax rates are shown on investments pre-ERTA, during 1981 and 1982, and in the future under the Tax Equity and Fiscal Responsibility Act of 1982.

EFFECTIVE TAX RATES ON NEW DEPRECIABLE ASSETS

	Pre-ERTA	1981-1982 Law	Post 1982
Motor vehicles	26.0	-11.5	9.0
Average for all industries	42.2	21.8	28.4

Note: Assumes a 4 percent real after-tax rate of return and a 6 percent inflation.

The lower tax rates on investment in the automobile industry relative to other industries is the result of the relatively intensive use of short lived machinery and equipment that generally is subject to lower overall tax rates.

While ACRS makes available more favorable investment incentives the ability of automobile manufacturers to invest and fully utilize these incentives depends on a number of factors other than the tax system.

Question. Is the Japanese auto commodity tax (rates from 17.5 percent to 22.5 percent) a deterrent to U.S. trade?

Answer. The Japanese commodity tax on autos is assessed on both domestic and imported automobiles in Japan. A tax of 17.5 percent is levied on small cars (engines of less than 2000 cc); for cars with engines larger than 2000 cc the tax is 22.5 percent. Unlike a comprehensive value-added tax which would be assessed uniformly across-the-board, the commodity tax is specific to a particular sector. Still, since it is one element in a geralized system of commodity taxes, its sectoral effect is offset by taxes on other commodities.

The U.S. auto industry argues that:

(1) The auto commodity tax artificially depresses demand for autos in Japan, introducing a distortion in favor of production for exports.

(2) The commodity tax hits imports from the United States harder than cars produced in Japan.

Because the automobile commodity tax is not uniform, it may depress domestic demand in the automobile sector and cause some increase in exports. But any impact on domestic consumption, and thus exports, will be largely offset by the other commodity taxes in the Japanese fiscal system. It is also unlikely that Japanese automobile exports would be significantly affected if the system of commodity taxes was repealed (to be replaced by direct taxes) or if the commodity taxes were no longer rebated on exports and levied on imports. In either case, the tendency for exports to fall and imports to increase would be offset by a devaluation in the Japanese yen relative to the dollar.

The charge that U.S. exports to Japan are taxed at a higher rate than Japanese vehicles is generally true. However, this is not the result of systematic discrimination against U.S. cars. Because the tax is assessed on the basis of engine size, U.S. vehicles with their larger engines are assessed at a rate of 22.5 percent. Thus, the U.S. produces no autos small enough to qualify for the 17.5 percent rate applicable to most Japanese autos. Japanese officials, however, have not been willing to change the breakpoint for engine size so that the smaller U.S. cars would be assessed at the lower rate even though it could be done in a way that met Japanese revenue objectives.

Question. Since the U.S. is a "direct tax" nation (that is where the bulk of the tax burden is built into products through corporate and personal income taxes, property taxes, Social Security taxes, and payroll taxes), the U.S. cannot, under GATT rules, rebate any part of the products' tax burden on export. Can you comment on this?

Answer. The General Agreement on Tariffs and Trade (GATT) permits destination principle border tax adjustments for indirect taxes such as sales or value-added taxes, but not for direct taxes such as the corporate or individual income tax or the Social Security tax. In other words, indirect taxes can be imposed on imports and rebated or not levied on exports, but no explicit adjustments can be made for direct taxes.

It is not clear, however, that the United States would benefit from a renegotiation of the GATT rules. Critics of the existing rules argue that they discriminate against the United States because: (1) U.S. exports must bear the burden of U.S. income taxes in addition to the importing country's excise, value-added, and other indirect taxes; and (2) U.S.-domestic producers must bear U.S. income taxes and still compete with foreign imports bearing neither foreign sales nor value-added taxes, nor U.S. income taxes. In effect, the argument assumes that our trading partners have low direct taxes. This assumption, however, is questionable.

If one compares taxes as a percent of gross domestic product for the United States and its major trading partners, the United States emerges as a relatively low-tax country, both with respect to direct and indirect taxes. Thus, application of the destination principle to all direct taxes (or substituting indirect taxes for direct taxes) would give most of our trading partners larger adjustments (export rebates and import taxes) than would be available to the United States.

Like the United States, Japan also is a low-tax country. The U.S. automobile industry therefore has argued that Japanese auto exports have a competitive advantage because they do not bear a "fair share" of Japan's tax burden because the commodity tax is rebated, making the auto industry's total direct and indirect tax contribution less than for other industries. In effect, however, the difference in auto tax burdens could be seen as not that Japan rebates its commodity tax, but that the United States does not impose an equivalent tax of its own on U.S. consumers of cars.

It is doubtful that steps to change the situation would be of significant benefit to the U.S. automobile industry:

If Japanese commodity taxes are eliminated on some or all commodities, direct taxes would likely be raised to offset the resulting revenue loss. The increase would, however, be borne by all Japanese industries, not just the auto industry. Any tendency for exports to fall and imports to increase would be offset by a devaluation of the Japanese yen. Thus, the impact on exports of the Japanese auto industry would be minimal.

If the United States imposed a similar tax, U.S. autos would have to be taxed as well, further depressing the already disastrously low levels of U.S. demand. (U.S. manufacturers are not now successful exporters and cannot turn to export markets as they charge Japan does.)

Question. What is Treasury's view regarding the claims that this bill will encourage more Japanese and foreign investment in the United States?

Answer. This bill is unlikely to encourage Japanese and foreign investment in the United States. Under the broad definition of local content, many foreign manufacturers would already be able to meet local content levels as high as 40 percent without substantial increases in U.S. investment or parts purchases.

Another factor weighing against increased investment in the United States is the risk that, once enacted, local content requirements would be amended to be more stringent. As a result, investments by foreign auto manufacturers might no longer be able to operate efficiently.

Question. What are Treasury's views on the effectiveness and administrative feasibility of tax incentives for employee stock ownership in auto companies as a means of reducing labor-management tensions that are believed to be a deterrent to productivity improvement in that industry?

Answer. The present structure of the tax system allows any personnel policy costs, including the cost of common stock issued to employees as part of their compensation, to be deducted currently by an employer. There is nothing in the tax laws that discriminates against the acquisition of equity interests in corporation-employers by employees. If employee ownership of stock effectively increases employee productivity, reduces labor cost per unit of output, it is reasonable to expect common inclusion of discount sales of stock to employees in compensation packages. In fact, this form of compensation is common only for managerial level employees. Other employees are frequently offered the option of buying shares at a discount, but this purchase is voluntary on the part of employees and is made with their own after-tax funds; it is not a part of their contractual compensation.

In part, the absence of discount stock in the compensation packages of production employees can be explained by the constraints of corporation financial management: few, if any, industrial corporations are in a position to issue unlimited quantities of common stock, as would be necessary if a significant portion of their labor costs were to be paid for in this way. More importantly, they are under no pressure to do so because, for many employees, investment in corporate stock, and particularly concentrated investment in the stock of their employers, may not be a desirable part of their portfolios.

It would be dubious public policy to intervene in labor-management relations by subsidizing the issuance of common stock to employees. Employees will recognize that receipt of stock is no different than any other equally valuable benefit or equivalent amount of cash. Indeed, if there is a ready market for the stock, receipt of stock is essentially the same as receipt of cash (except for the costs of trading). An employee who doesn't want to hold it can sell it, just as an employee who wishes to hold such stock can buy it out of wage income.

Chairman GIBBONS. We will recess until 2 o'clock.

[Whereupon, 12:47 p.m., the subcommittee recessed, to reconvene at 2 p.m.]

AFTERNOON SESSION

Chairman **Gibbons**. The Chair will take a little license and ask all to come forth at one time. We have Mr. William A. Niskanen, a member of the Council of Economic Advisers.

I would then ask Mr. Tracy, Mr. Cogan, and Mr. Convisser to all come forward, too. We will just take all of you as a panel if you will, please. Are they here in the room?

Suppose we start with the Council of Economic Advisers first?

Mr. **Bailey**. Mr. Chairman, before they proceed, could you answer a question?

You are much more expert in this than I am. I had a question about the procedural aspect of individual joint with sequential referral. You commented on it briefly before the first panel started.

Chairman **Gibbons**. As I understand it, this goes to the floor no matter what we do.

Mr. **Bailey**. That was my understanding, that in the sequential referral, that the main committee, to which it is referred reports that bill out, then it is reported to us. If they report it out, what action we take with it really doesn't matter.

Chairman **Gibbons**. That is correct, unless we had a substitute or something like that. I can't see improving this thing at all, but we have a sequential referral by mistake.

The mistake was that we didn't get the bill initially. If the bill had been referred properly—the Parliamentarian told me he made a mistake and I believe him—we would have had this bill a year ago, and we would have been the primary committee handling it.

Mr. **Bailey**. Thank you, Mr. Chairman.

Chairman **Gibbons**. You may proceed.

STATEMENT OF WILLIAM A. NISKANEN, MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. **Niskanen**. Mr. Chairman, members of the subcommittee, thank you for the opportunity to testify on the effects of H.R. 5133.

My remarks today focus on the direct effects of this bill on employment in the automobile and related industries and on auto prices. At this stage these estimates must be represented as CEA estimates because they have not yet been reviewed by our normal interagency review process.

We also have not had the opportunity to evaluate the possible macroeconomic effects of this bill, because these effects depend on many other conditions.

The administration opposes this bill and other domestic content legislation for a variety of reasons. Among the most important is the distortions that would occur in the automobile sector. Although this bill would undoubtedly raise employment in the auto industry, it would impose costs on consumers that far outweigh the benefits to auto workers.

The Council of Economic Advisers estimates that the average price of a new car would rise by about $470 in 1980 dollars, or 6.4 percent, if H.R. 5133 were passed.

Chairman GIBBONS. Give me that again. I was distracted for a moment.

Mr. NISKANEN. We estimate that the average price of a new car would rise by about $470 in 1980 dollars, or about 6.4 percent, if this bill were passed.

This number is a weighted average of price increases for five different categories of cars, including 17 percent for Japanese subcompacts, 13 percent for Japanese compacts, 5 percent for U.S. subcompacts, 4 percent for U.S. compacts, and less than 1 percent for U.S. larger cars.

In total, consumer costs would rise by almost $6.4 billion, again in 1980 dollars, if H.R. 5133 restricted our trade in automobiles.

Chairman GIBBONS. $6.4 billion?

Mr. NISKANEN. $6.4 billion.

As I will explain later, Mr. Chairman, all of these estimates are specific to a strong sales year, in which total sales of cars and light trucks are 15 million units.

The level of consumer costs would be lower, in the range that was represented this morning of about $5 billion at current sales levels.

In exchange for the increase costs borne by consumers, employment in the auto and related industries would rise as a function of this revised bill by about 65,000 jobs. A larger number, of course, was discussed this morning, but that was specific to the prior bill.

Chairman GIBBONS. You say 65,000 jobs. You say you estimate this bill would add 65,000 jobs?

Mr. NISKANEN. Of the revised bill. That 65,000 includes about 17,500 additional jobs in U.S. assembly plants producing Japanese cars, 17,000 additional jobs in plants producing parts for Japanese cars, 9,300 extra auto industry jobs in firms producing U.S. cars, and 21,700 jobs in auto-related industries.

While this increase in auto-related employment may seem attractive, it is not cheap. Each additional job created in auto and related industries would cost consumers almost $100,000 in higher prices. This is approximately four times the annual earnings received by a full time UAW worker.

It would be far less expensive for U.S. consumers to continue importing Japanese cars and then to pay auto workers their wages for remaining idle than to suffer the costs imposed by this bill.

The Congress of the United States would never, I trust, support legislation that spent tax money in such an extravagant fashion. Nor should it spend consumer dollars so wastefully, simply because the costs are dispersed among millions of car buyers and not published in the Federal budget.

We should use the same standards to judge Government actions regardless of whether costs are paid by citizens as taxpayers or citizens as consumers.

Part of the higher costs paid by consumers would simply be a transfer to United States workers and Japanese and United States automobile companies in the form of higher earnings and higher profits.

Unfortunately, most of the increase in consumer costs would benefit no one. It disappears in inefficiency, forgone automobile purchases, and reduced consumer choice.

This so-called deadweight loss to the economy equals the increase in consumer costs minus the increase in auto sector incomes.

Under H.R. 5133, it would total almost $4 billion, or about $60,000 per job. In a period of fiscal restraint, the United States cannot afford to spend $60,000 on each job created in the domestic auto industry.

Even within auto and related industries, H.R. 5133 would not be a universal blessing. Although sales of cars by U.S. manufacturers would increase by around 200,000 units, Japanese sales would fall by 1 million units. This would mean fewer jobs for longshoremen, truck drivers, sales personnel, and other workers who bring Japanese cars from the dock to the customer.

Thus this bill would not only transfer income from consumers to auto workers. It will also have the effect of laying off some auto-related workers in order to hire others.

In estimating the effects of H.R. 5133, Mr. Chairman, one must necessarily make numerous assumptions concerning events that are in many cases hard to predict. All of the conclusions I have discussed assume that the local content requirements, if enacted, would be perceived to be permanent, and under those conditions Japanese producers would respond by moving some production to this country. Specifically, these estimates are based on the assumption that the three largest Japanese firms—Toyota, Nissan, and Honda—would each choose to assemble half a million cars in this country by the time this legislation goes into effect.

In addition, the top five Japanese importers are assumed to buy domestically produced components such as tires, radios, and air-conditioners, typical add-on components. These components in turn are assumed to be worth 10 percent of the wholesale price of each vehicle.

I have also assumed that transportation, advertising, and other existing costs would comprise 20 percent of the wholesale price of Japanese vehicles.

Present evidence suggests that this margin now represents roughly 15 percent of the wholesale price of these vehicles, but I think a bit of creative accounting would likely increase that. Thus, Japanese firms would be able to import up to 200,000 units annually without any U.S. manufacturing content in their vehicles.

In addition, the results are based on a strong sales year in which total sales of cars and light trucks are 15 million units in the absence of any restraints on imports.

Finally, I have assumed that U.S. manufacturers respond to the increase in the price of Japanese vehicles by an equal percentage increase in the price and volume of U.S. vehicles.

Most of the results of this analysis are robust with respect to reasonable variations in these assumptions, except for the final assumption; a higher price response by U.S. manufacturers would reduce the job effect and increase the consumer costs per additional job.

Mr. Chairman, I hope that I have been able to convince you and the members of this subcommittee that the high cost to consumers is reason enough for rejecting local content legislation as a way of increasing auto employment.

I do not want to leave you with the impression, however, that these are the only costs involved. Other American workers, in other industries, may also be harmed by this bill.

As I have mentioned, retail and transportation employment related to the importation of Japanese cars would decline as total auto sales fall.

In addition, lower imports of Japanese cars would tend to raise the value of the dollar relative to other currencies. This would make our exports less competitive in foreign market and make imports from other countries more competitive in this country.

This effect would occur in the absence of any formal retaliation to what is clearly a violation of GATT.

Workers in our export industries, and those in import-competing industries that are not as well protected as automobiles, may lose their jobs simply because of the higher value of the dollar.

Furthermore, as emphasized this morning, passage of this bill may result in retaliation by other countries. Domestic content legislation violates the terms of the GATT. Countries that suffer from this type of trade barrier are eligible for compensation. A trade barrier that excludes 1 million autos a year, worth up to $6 billion, is without precedent.

Although it is difficult to predict what specific form compensation for such a large amount would take, it would probably take the form of lower U.S. trade barriers in some other sectors.

The final result could be an increase in employment in auto and related industries, a decrease in other importing or exporting industries, with little net change in total U.S. employment.

A bill that produces little or no increase in total employment while imposing billions of dollars of costs on consumers is not good legislation. I urge you to join the administration in opposing H.R. 5133.

Thank you again, Mr. Chairman, for this opportunity to discuss the employment and price effects of H.R. 5133. I would be pleased to respond to any questions you might have.

[The prepared statement follows:]

STATEMENT OF WILLIAM NISKANEN, MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to testify on the effects of H.R. 5133. My remarks today focus on the direct effects of this bill on employment in the automobile and related industries and on auto prices. We have not had the opportunity to evaluate the possible macroeconomic effects of this bill, because these effects depend on many other conditions.

The Administration opposes this bill and other domestic content legislation for a variety of reasons. Among the most important is the distortions that would occur in the automobile sector. Although this bill would undoubtedly raise employment in the auto industry, it would impose costs on consumers that far outweigh the benefits to auto workers.

The Council of Economic Advisers estimates that the average price of a new car would raise by about $470 (in 1980 dollars) or 6.4 percent, if H.R. 5133 were passed. This number is a weighted average of price increases for five different categories of cars, including 17 percent for Japanese subcompacts, 13 percent for Japanese compacts, 5 percent for U.S. subcompacts, 4 percent for U.S. compacts, and less than 1 percent for U.S. larger cars. In total, consumer costs would rise by almost $6.4 billion (again, in 1980 dollars) if H.R. 5133 restricted our trade in automobiles.

In exchange for the increased costs borne by consumers, employment in the auto and related industries would rise by about 65,000 jobs. This includes about 17,500 additional jobs in U.S. assembly plants producing Japanese cars, 17,000 additional jobs in plants producing parts for Japanese cars, 9,300 extra auto industry jobs in firms producing U.S. cars, and 21,700 jobs in auto-related industries.

While this increase in auto-related employment may seem attractive, it is not cheap. Each additional job created in auto and related industries would cost consumers almost $100,000 in higher prices. This is approximately four times the annual earnings received by a full time UAW worker. It would be far less expensive for U.S. consumers to continue importing Japanese cars and then to pay auto workers their wages for remaining idle than to suffer the costs imposed by this bill.

The Congress of the United States would never (I trust) support legislation that spent tax money in such an extravagant fashion. Nor should it spend consumer dollars so wastefully, simply because the costs are dispersed among millions of car buyers and not published in the Federal budget. We should use the same standards to judge government actions regardless of whether costs are paid by citizens as taxpayers or citizens as consumers.

Part of the higher costs paid by consumers would simply transfer to U.S. workers and Japanese and U.S. automobile companies in the form of higher earnings and higher profits. Unfortunately, most of the increase in consumer costs would benefit no one. It disappears in inefficiency, foregone automobile purchases, and reduced consumer choice. This deadweight loss to the economy equals the increase in consumer costs minus the increase in auto sector incomes. Under H.R. 5133, it would total almost $4 billion, or about $60,000 per job. In a period of fiscal restraint, the United States cannot afford to spend $60,000 on each job created in the domestic auto industry. Even within autos and related industries, H.R. 5133 would not be a universal blessing. Although sales of U.S. cars would increase by around 200,000 units, Japanese sales would fall by 1 million units. This would mean fewer jobs for longshoremen, truck drivers, sales personnel, and other workers who bring Japanese cars from the dock to the customer. Thus, this bill would not only transfer income from consumers to auto workers. It will also have the effect of laying off some auto-related workers in order to hire others.

In estimating the effects of H.R. 5133, Mr. Chairman, I have had to make numerous assumptions concerning events that are very hard to predict. All the conclusions I have discussed assume that the local content requirements, if enacted, would be permanent, and that Japanese producers would respond by moving some production to this country. Specifically, I have assumed that the three biggest Japanese firms (Toyota, Nissan, and Honda) would each assemble half a million cars in this country by the time this legislation goes into effect. In addition, the top five Japanese importers are assumed to buy domestically produced components such as tires, radios, and air conditioners. These components are assumed to be worth 10 percent of the wholesale price of each car. I have also assumed that transportation, advertising, and other existing costs would comprise 20 percent of the wholesale price of Japanese cars. Thus, Japanese firms would be able to import up to 200,000 units annually without any U.S. manufacturing content in their cars. In addition, the results are based on a strong sales year in which total sales of cars and light trucks are 15 million units in the absence of any restraints on imports. Finally, I have assumed that U.S. manufacturers respond to the increase in the price of Japanese vehicles by an equal percentage increase in the price and volume of U.S. vehicles. Most of the results of this analysis are "robust" with respect to reasonable variations in these assumptions, except for the final assumption; a higher price response by U.S. manufacturers would reduce the job effect and increase the consumer costs per additional job.

Mr. Chairman, I hope that I have been able to convince you and the members of this Subcommittee that the high cost to consumers is reason enough for rejecting local content legislation as a way of increasing auto employment. I do not want to leave you with the impression, however, that these are the only costs involved. Other American workers, in other industries, may also be harmed by this bill. As I have mentioned, retail and transportation employment would decline as total auto sales fall. In addition, lower imports of Japanese cars would tend to raise the value of the dollar relative to other currencies. This would make our exports less competitive in foreign markets and make imports from other countries more competitive in this country. Workers in our export industries, and those in import-competing industries that are not as well protected as automobiles, may lose their jobs, simply because of the higher value of the dollar.

Furthermore, passage of this bill may result in retaliation by other countries. Domestic content legislation violates the terms of the GATT. Countries that suffer from this type of trade barrier are eligible for compensation. A trade barrier that excludes 1 million autos a year, worth up to $6 billion, is without precedent. Although it is difficult to predict what form compensation for such a large amount would take, it would probably take the form of lower U.S. trade barriers in some other sectors. The final result could be an increase in employment autos and related industries, a decrease in other importing or exporting industries, with little net change in total U.S. employment. A bill that produces little or no increase in total employment while imposing billions of dollars of costs on consumers is not good legislation. I urge you to join the Administration in opposing H.R. 5133.

Thank you again, Mr. Chairman, for this opportunity to discuss the employment and price effects of H.R. 5133. I would be pleased to respond to any questions you might have.

Chairman GIBBONS. Fine.

Before we go to questions, we will go to the Department of Labor because I understand our witness from the Department of Labor has a conflict.

Mr. Cogan.

STATEMENT OF JOHN COGAN, ASSISTANT SECRETARY FOR POLICY, DEPARTMENT OF LABOR

Mr. COGAN. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I welcome the opportunity to testify on HR. 5133. You have already heard testimony from other administration officials on various aspects of this bill.

As the representative from the Labor Department, I will confine my remarks to the implications of H.R. 5133 for the employment of American workers.

Let me say at the outset that this administration is concerned about the serious unemployment situation of American autoworkers. The automobile industry has traditionally been a major source of employment. A little over 4 years ago employment in the industry reached a peak of nearly 1 million people.

Today, as we all know, the situation is quite different. The combination of back-to-back recessions, high interest rates, and high fuel costs have resulted in a loss of almost 300,000 jobs and an unemployment rate of over 20 percent.

While I recognize and sympathize with the economic hardships of the unemployed autoworkers, I do not believe that passage of H.R. 5133 would be in the best interests of all American workers.

Proponents of the bill argue that it is a job creation bill needed to revitalize our Nation's automobile industry. However, as previous administration officials have pointed out, the job creation argument is a fallacy.

H.R. 5133, no matter how it is drafted, is not the job creation bill advertised by its proponents.

Domestic content does not primarily create jobs; rather, it swaps jobs in some industries for jobs in other industries. Nor will the bill revitalize our Nation's automobile industry because the industry's major problems are not caused by imports.

Since the peak production year of 1978, domestic sales have declined by about 4.5 million units. During the same period of time, sales of imported autos rose by only 460,000 units. Accordingly, only about 10 percent of the reduction in domestic auto sales during this period can be attributed to increased import penetration.

Domestic content legislation may create additional jobs in the automobile industry. But it would do so primarily by taking jobs away from other American workers. This simple and inescapable fact has been conveniently ignored by those who argue in favor of the bill.

But the fact remains: Regardless of the particular formula used to define domestic content, regardless of the length of time over which the legislation is phased in, and regardless of the level of foreign content permitted, domestic content is a job swap program, not a job creation program.

Modification of the bill's specifications would only affect the size of the tradeoff between jobs created in one sector and jobs destroyed in others.

This reason alone would be sufficient for the administration to oppose domestic content legislation in any form.

Initially a domestic content bill would produce job losses among dockworkers and other workers in our import distribution network. But these are not the only American workers who would suffer. They are only those who would be most immediately affected. The major job losses would be sustained in the longer run by workers in our exporting and import competing industries. This would be the case even without Japanese retaliation.

As you are no doubt aware, this point is often overlooked.

Let me try to explain how it would occur. The decline in auto imports caused by this bill would reduce the number of dollars that Americans offer in return for imported autos. This reduction in the supply of dollars in foreign exchange markets would drive up the price of the dollar.

Since foreign purchasers of our exports require dollars to pay for these goods, a higher price of the dollar is automatically translated into a higher rice for our exports. As a result, exports would decline. Workers in America's export industries, primarily high technology industries and agriculture, would lose their jobs.

Those American producers who compete with imports other than autos would also suffer. As the dollar appreciates, American consumers would find it cheaper to buy from abroad. For example, more clothing and shoes would be imported. American workers in these, as well as other high unemployment industries, would face more layoffs.

These effects are an inevitable consequence of flexible exchange rates. That they would occur is not debatable. What is debatable is the size of the exchange rate adjustment.

The larger the impact of domestic content legislation, the larger will be the exchange rate adjustment and the larger will be the job loss in our exporting and import competing sectors.

Hence the details of a domestic content bill only affect the size of the swap between jobs created in one industry and jobs destroyed in others.

The alluring feature of domestic content legislation is that those for whom jobs are created are readily identified. Its cruelest feature is that those who pay for the legislation by losing their jobs are not so easily identified and, as a consequence, tend to be overlooked.

In closing, we share your concerns about the plight of American auto workers. But this legislation is not an appropriate solution.

Thank you, Mr. Chairman.

Chairman GIBBONS. All right, sir. I couldn't agree with you two more. Go right ahead, Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Thanks for that extra 5 minutes of your time that you are giving me.

Chairman GIBBONS. You can have 10 or 15, you are doing so well.

Mr. BAILEY. I really appreciate it. Mr. Buckley is not here.

Mr. Cogan, and this is Mr. Niskanen.

Chairman GIBBONS. On your right.

Mr. BAILEY. Thank you, Mr. Chairman.

Gentlemen, if I follow your logic, and by the way I think you do some of the best cost/benefit analyses I have ever heard—I think it is just incredible. I really do. But I have been through it with some of your folks before.

If the increased cost to an American consumer is, and this is sort of a nonsense question, $640 a car, maybe we ought to employ less auto workers. Apparently it is more efficient or a better buy.

Maybe, given the unemployment compensation costs either which you have computed to be to the disadvantage of the average American consumer and taxpayer, I presume, if we pass this legislation on its economic merits, and I am not extrapolating all those related trade predictions that everyone is making, of course, at $640 a car, maybe what the society needs is to employ less auto workers.

Does it make better sense for efficiency purposes? I mean, are we at some optimum now, or if we employed less could we get even cheaper cars?

Mr. COGAN. Let me try to respond.

Mr. BAILEY. Would you please, Mr. Cogan? I would appreciate it.

Mr. COGAN. The optimal mix between capital and labor in the automobile industry is best determined by labor and management working together, not by Mr. Niskanen nor myself sitting in Washington.

Mr. BAILEY. I am very much aware of that. Thank God. That is that free market you and I are concerned about, right?

Go ahead.

Mr. COGAN. As a consequence, for us to try to respond to whether there is an overuse of workers and underuse of workers in the industry is certainly not appropriate.

Mr. BAILEY. Oh, that is not my question. You are telling me this bill doesn't pay, right, John? It just flat doesn't pay, that is what you are saying, and I am just wondering if it pays better if we import more Japanese automobiles and employ less autoworkers? I just wonder if the aggregate figures of how it pays get better. Do they?

Mr. COGAN. I am not sure how we would accomplish increasing importing workers and the like.

Mr. BAILEY. It is a difficult question to answer, I am sure. How did you do this cost/benefit analysis work which you folks worked up?

Mr. NISKANEN. Any such calculations require, as I said, a number of assumptions which individually are subject to some variation. We first estimated what would be the likely response of the Japanese manufacturers to this revised Ottinger bill—in terms of their incentives for bringing in cars under the 20-percent limit in effect without any domestic add-ons, within the 30-percent limit which would involve domestic components such as tires, air-conditioning and radios, and then within roughly a 50-percent domestic content limit which would include assembly, but no substantial production of domestic components.

Mr. **Bailey**. Then perhaps since Mr. Cogan was apparently—pun is not intended—but laboring with the question I just asked, you can respond then in terms of your analysis to the question I raised.

Would it pay us as a society better to employ less U.S. autoworkers?

Mr. **Niskanen**. Society as a whole doesn't make that decision.

Mr. **Bailey**. Oh, it would not. We are at a nice pleasant figure now. Given the reaction of Japanese auto workers, auto manufacturers, could we come up with better than a $640 an average car bargain because apparently the import mix would be higher in this scenario you outline and we can make the consumer an even better bargain by squeezing more American auto manufacturers.

Mr. **Niskanen**. Mr. Bailey, I think we ought to back up. I don't know what was the source of your estimate of $640 per car.

Mr. **Bailey**. That figure was taken from a figure that you gave.

Mr. **Niskanen**. From this morning's presentation, I suppose?

Mr. **Bailey**. No.

Mr. **Niskanen**. That was probably an estimate based upon the original Ottinger bill. Our estimate of the average price——

Mr. **Bailey**. I just wrote that down here.

Mr. **Niskanen**. The average price of cars in the United States would increase by about $470 in 1980.

Mr. **Bailey**. $470. Could I change my questions substantively from $640? I was wrong. To $470. Would you answer it on that basis?

Mr. **Niskanen**. Our estimate is that the average price of U.S. cars would increase by about $470 as a consequence of this bill and that is what would lead to a total cost to American consumers of about $6.4 billion.

American consumers would be paying roughly $6.4 billion more than they would have in the absence of this bill.

Mr. **Bailey**. What you are saying is, they would pay more for automobiles, and you are saying that the consequences are such that the advantages to be offset for increased employment, those advantages would not match what they would have to pay in increased cost for automobiles?

Mr. **Niskanen**. I am saying that they would pay $6.4 billion more for automobiles, cars and light trucks, which would represent about $100,000 per additional jobs created in the auto specific industry.

Chairman **Gibbons**. Per year?

Mr. **Niskanen**. Per year.

Mr. **Bailey**. I understand that, figuring on a $25,000 average wage, I think it was.

Mr. **Niskanen**. They earn roughly $25,000 in earnings. A fully employed auto worker costs a total amount of about $39,000 a year.

Mr. **Bailey**. But your thesis is that this bill costs us more?

Mr. **Niskanen**. I have several conclusions from this, Congressman. One is that it costs consumers a great deal for each additional job created, and it costs them a great deal more than the cost of just hiring that person and leaving him idle.

Mr. BAILEY. That is my question. Then should we not employ, or rather disemploy more auto workers? It seems simplistic, but given what you are telling me, are we at some optimum point in the curve? That is my question. It seems silly, but you think about what you folks are saying, what you are really telling us is that perhaps, given the present market share and the present rate of employment, it is costing us. It is inefficient to employ the ones we are employing.

Mr. NISKANEN. It is quite clear that at present sales levels, it would be inefficient to employ the 220,000 auto workers who are on indefinite layoff.

Mr. BAILEY. At present sales levels, and you are factoring in, of course, the respective domestic and foreign market shares?

Mr. NISKANEN. That is correct.

Mr. BAILEY. Let's keep those respective market shares.

Mr. NISKANEN. And that decision has been made by the companies?

Mr. BAILEY. By the companies?

Mr. NISKANEN. By the companies. In other words, they have chosen to lay off 220,000 people on an indefinite layoff, given present sales levels and the existing labor costs in that industry.

Mr. BAILEY. How does Japan deal with labor as an overhead item? Is it a fixed cost? How do they deal with it? Do you know?

Mr. NISKANEN. In the industrial sector in Japan, a substantial part of annual compensation is in the form of a bonus, which is variable as a function of the well-being of the company, so, although they maintain—we have chosen a system in which by and large we maintain——

Mr. BAILEY. I——

Mr. NISKANEN. Mr. Bailey, do you wish me to respond or not?

Mr. BAILEY. No, because we both know the answer.

I was just teasing you a little bit.

Mr. NISKANEN. Let me respond to the question you ask. Japan has a quite different labor practice than we do. They try to maintain employment by varying effective labor costs. We try to maintain——

Mr. BAILEY. My follow-up question was going to be is that what leads to this argument about exporting unemployment? Do you think that is the basis, maybe?

Mr. NISKANEN. I don't understand the basis for that argument.

Mr. BAILEY. You don't understand the basis. I see.

Mr. NISKANEN. We have chosen for a variety of reasons a quite different labor policy. Basically American firms try to maintain wage rates and to vary employment.

The Japanese have opted for just the opposite, to maintain employment and vary effective compensation.

Mr. BAILEY. I think the reasons for those policies run a lot deeper. They are not just simple choices.

They have a lot to do with the system. I think they have a lot to do with—this is obvious, I suppose—relationship between industry and Government, role and function of Government, what we call private enterprise, and so forth. I think the cost/benefit analysis that you guys came up with has got a major difficulty with it, and that is that in terms of the cost/benefit analysis which eventually is going to be based on some type of efficiency or productivity analysis or argument, it makes a hell of a lot more sense judging by what you guys are telling me, we ought to employ less of those doggone auto workers out there. That is what you are really telling me, and we can sell cheaper cars and employ more people and provide a better cost/benefit ratio to the average American consumer taxpayer than we are even right now. I think that is not only politically and socially inane, but I just don't know, with all due respect to the cost/benefit analysis if it's an effective way to deal with this policy consideration that this legislation is trying to——

Mr. **Niskanen**. Mr. Bailey, I would agree with you that it would be better for these auto workers to be employed in another industry than to be unemployed in the auto industry.

Mr. **Bailey**. That is what I was after. You have just done what no other panel member and no one else has. That is the most honest answer we have had out of any of our panel members.

Mr. **Niskanen**. Let me repeat though just exactly what I said. It would be better for these people to be employed in another industry than to be unemployed in the auto industry.

Mr. **Bailey**. Very good. Thank you, Mr. Chairman.

Chairman **Gibbons**. Do you want some more time?

Mr. **Bailey**. Yes, I would. Other members might object. Certainly.

Chairman **Gibbons**. Let's go to Mr. Brodhead next.

Mr. **Brodhead**. Thank you, Mr. Chairman.

I am not going to hopefully take the whole 5 minutes that I have. I am a little troubled by the testimony here. I always marvel at economists, how they can make a whole string of assumptions which have to be questionable, and in this case are highly questionable, and in some cases contradictory one with the other, and then proceed from that point to a great deal of certitude.

Mr. Cogan's testimony is really sort of backwards. He starts with the number of $470 that he claims the price of a car would raise by, does his math on that basis, and proceeds to show that that doesn't make any sense if the price rises by $470 a car.

Then in the back of his paper he begins to tell us a little about how he got to that number by a whole string of assumptions.

Of course, that is what we ask economists to do for us, and they have to work with what they can work with. We all know that it is very highly speculative, and so I am really very troubled, as I am sure any scholar is troubled by building an argument on the basis of a whole lot of assumptions like that.

I think the point that my colleague, Mr. Bailey, was making, is certainly—I would take over on that by saying this: Certainly there is not a totally free market in automobiles. Lots of actions are taken by our Government and lots of actions are taken by the Japanese Government and they affect both the price of cars and how many foreign cars are going to be sold in this country.

If there are great savings accruing to American consumers because we are having 25 to 30 percent of the cars sold in the United States imported, maybe we would have even greater savings if 60 or 70 percent of the cars were imported, but we all know, and as

Mr. Bailey was suggesting, there are lots of other issues involved, which we haven't talked about here; namely, what is the cost of unemployment, the social cost.

What is the cost of lost production capacity? What is the cost in our self-esteem as a nation of the current policies that we are following?

We find that the Japanese industry, we know that the Japanese industry itself, auto industry, a highly successful industry, was built behind a protectionist wall and that that worked very well and that the Japanese Government, the private sector, worked very closely together to coordinate policies to maximize the sales of Japanese automobiles at home and abroad.

We feel, at least this administration feels, and many people outside the administration feel that that is not good policy, that we are better off doing it in another way, but I think that what we have seen, Mr. Chairman, is one major American industry after another get gobbled up in this process, the television industry, the steel industry, and now the auto industry.

While we may think we are playing chess, they are playing monopoly; sooner or later there is a cost to be paid for this. We can talk about services all we want, but we are not going to be a viable economic or military power in the world by cleaning each others' houses and selling each other cheeseburgers.

We have to have a heavy industry capacity in this country not only from the national security standpoint, but for other major reasons as well, if we are going to be thought of and actually be a viable economic force in the world. While I don't want to argue necessarily with what the witnesses are stating, given their philosophy and their background and the position that the administration has taken, perhaps they have done the best that they can, I am sure we all realize, as I am sure they realize, being very intelligent and scholarly people, that many of these assumptions are very highly questionable. We know from lots of experience, some of it quite recent, that economic projections can be heavily influenced and that the recent history of economic projections in this administration, as in previous administrations, has been very, very far shy of the target. We really ought to think about other factors and think about what makes sense from a commonsense point of view, and not ascribe to these sorts of questionable projections any greater weight or value than they deserve.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you.

Mr. SCHULZE. Thank you, Mr. Chairman.

Thank you, gentlemen, for your testimony, your presentation. There are those who do believe that we should become the serviceman of the world, that we don't really need to have basic industries and heavy industries.

I presume that you are not among those that advocate that?

Mr. NISKANEN. That is correct.

Mr. COGAN. Not I.

Mr. SCHULZE. How then do we protect our industry base? I am coming at this whole issue quite frankly as a matter of retaliation, not as a matter of policy, saying we have been dealt with unfairly; we don't see the situation being corrected, and we are not going to roll over and play dead for this any more in the future, and I think that message should be sent.

We are willing to deal on a fair and equitable basis anywhere in the world and if we can't compete on an equitable basis, that is tough, but it seems to me that the competitive situation in the world in foreign trade is not apples and apples and oranges and oranges.

We do have massive Government intervention in planning and strategy. If this is not the vehicle, do you have any suggestions on how we should attack this or how we should send the message, other than the normal diplomatic route which doesn't seem to work?

Mr. COGAN. Congressman, let me attempt to respond. We share the same objectives. The best way to increase our export capacity, the best way to insure protection of our industries that compete with imports, without incurring a substantial cost, is to get foreign trade barriers down.

I think we have a disagreement here over whether this specific policy, domestic content legislation, will get trade barriers down.

The administration clearly believes it won't. In fact, the administration clearly believes that the result will be retaliation, ultimately raising trade barriers, further crippling some of our exporting industry.

You believe that by sending a message to our foreign trading partners, that barriers will come down. Many individuals are not sure who is right.

Mr. SCHULZE. I think you are right. That is the crux of the problem, but from my point of view we have been trying, we have pleaded, we have cajoled, we have begged, we have threatened, we have done everything with very little effect. It seems to me the time has come to take action, and there are legitimate times for protectionism.

In the late 1700's we were a protectionist nation trying to develop our fledgling industry. I can understand Japan's protectionism after World War II.

I also think that there is a time for protectionism when you are the only one that seems to be playing by the rules, or there are very few that are playing by the rules, where the whole mode of international trade is changing, and if it is changing, then we ought to be with it.

We have got to perhaps give up some of our traditional ways.

The name of the game now is protect an industry, develop it and penetrate the world markets to be a little more specialized.

I don't know, but I think that we should perhaps be cognizant of this and if it is a changing situation, then we had better get with it.

Mr. COGAN. I understand your frustration about our foreign trading policy. I understand that that stems from the frustration your constituents have with the continued subsidization both formally and informally by foreign nations. I understand that that frustration has led many to call for us to retaliate, but what we are trying to emphasize here is that it is the American worker in other industies who pay for this retaliation.

He will lose his job. In addition, the American consumer will pay in the form of higher automobile prices.

Mr. **Schulze**. Yes, and to a degree you are right, but in the long run and I keep going back to the television industry, yes, the domestic consumer in Japan was forced to pay more for that television set for a period of time, but look at the overall good to the economy it has done by destroying the television industry everywhere else in electronics.

Suppose this happens to steel, shipbuilding, planes, the computer industry, automobiles. What do we have left?

Are we then in a position to be the serviceman for the world? I think the time to attack these is not after it is too late, but send that signal very strongly.

We have done it in a nice way. We have done it through the diplomatic channels, and it hasn't worked, and we have to go vote.

Mr. Chairman, I yield back and will pick up when we come back.

Chairman **Gibbons**. Mr. Pease.

Mr. **Pease**. Mr. Chairman, I will be very brief so we can make this vote.

Mr. Niskanen, I just want to clear up one thing in your testimony on page 3. You say "Although sales of U.S. cars would increase by around 300,000 units, Japanese sales would fall by 1 million units." Would somebody else make up the other 800,000?

Mr. **Niskanen**. No. Total sales would fall by about 800,000 from 15 million to 14.2, as a consequence of the higher prices.

Mr. **Pease**. You say on page 2 of your testimony that it would be less expensive for U.S. consumers to continue importing Japanese cars and then to pay autoworkers their wages for remaining idle than to suffer the cost imposed by this bill.

Then you say you trust the U.S. Congress would never support that legislation. That gets us to the subject of trade adjustment assistance which the administration has practically eliminated since it came into office.

Is it the position of the administration that you think that Congress, the administration, should not recognize in any way the loss of jobs by reason of imports in the auto industry?

Mr. **Niskanen**. Congressman, I think we all need to think through seriously what forms of adjustment assistance to workers are likely to be more effective than we have had to date. I don't see any reason for providing adjustment assistance as a function of why the adjustment is taking place.

Workers who are displaced by an industry just because of a drop of demand for that industry suffer the same losses in employment and income than they do if they are displaced by trade actions.

I don't think that we should make adjustment assistance specific to a finding that they were displaced by a trade action. At the same time, we should seriously consider changes in the nature of, for example, extended term unemployment benefits to facilitate adjustment by those workers rather than to facilitate continued unemployment dependence.

Mr. **Pease**. Thank you.

Mr. Buckley, I only have about 1 minute. I think you said in your testimony that it would be a violation of GATT if H.R. 5133 passed.

Mr. **Cogan**. I am sorry, Mr. Pease, I am Mr. Cogan from the Labor Department.

Mr. **Pease**. I am sorry. Where is Mr. Buckley?

Chairman **Gibbons**. He is not here. This is the Department of Labor.

Mr. **Pease**. Good grief. Mr. Cogan, I can't hold you responsible for our whole foreign policy.

Chairman **Gibbons**. Although he had an excellent statement.

Mr. **Pease**. Mr. Chairman, I wasted my time reading Mr. Buckley's statement and passed up Mr. Cogan's excellent statement. I will have to make amends for that.

Chairman **Gibbons**. I have some questions, but I had better go vote.

Mr. Cogan, we understand that you have to meet with the Secretary, is that right?

Mr. **Cogan**. Yes, sir.

Chairman **Gibbons**. I am going to excuse you, but I wonder, Mr. Niskanen, if you could stay a while.

Mr. **Niskanen**. Sure.

Chairman **Gibbons**. You have been so nice to be here all day, and you are very helpful.

Mr. Cogan, you are very helpful, too, but I understand the problems of running the Government.

Mr. **Cogan**. Thank you, Mr. Chairman.

Chairman **Gibbons**. If you will just wait, we will recess and be right back.

[Recess.]

Mr. **Bailey**. I wonder while we are waiting for others to get back, I might put some comments on the record. That will save some time.

Chairman **Gibbons**. Sure.

Mr. **Bailey**. This morning we had a discussion concerning the handling of the so-called countervailing duty or antidumping cases, and there was a significant disagreement between the information that I had received that had been communicated to me concerning Commerce's dealing with the issue and Mr. Baldrige's interpretation of how well his efforts were received by the steel companies and by the unions involved. So I made a few phone calls, and without naming names, I have checked with some of the top steel companies in the country. Their overall assessment is that while everyone agrees that Mr. Baldrige is a wonderful person, and I want to second that reaction, that they were not at all pleased with the long-term, long-range handling of the cases, specifically with some of the suggestions that were made in August 1982 concerning the treatment of German coal subsidies and British direct grants as so-called subsidy items. Although they felt that it was in good faith, they were not pleased that the jawboning that led to the postponement of Commerce's initiation of the cases inured not to their benefit, but to their detriment. Overall, they are not happy and have not been happy with the handling of the cases, although they don't feel that up until August, at least, there was an issue of bad faith on Mr. Baldrige's part.

I thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you. I hope some day Americans can become wealthy enough so that we can afford the steel industry that we have fallen heir to.

Mr. **Bailey**. I would love to debate that with you, Mr. Chairman.

Chairman **Gibbons**. I would love to debate it with you, too.

Mr. Frenzel.

Mr. **Frenzel**. Mr. Chairman, I don't want to let the record stand with the statement on it that Mr. Baldrige neglected and failed.

Mr. **Bailey**. If the gentleman will yield?

Mr. **Frenzel**. I do yield.

Mr. **Bailey**. I am glad, since there apparently was a question in the gentleman's mind that he made the statement he just did, because it is absolutely the converse of what I have just said. I say again, for the benefit of the record, that there was not, up until August 1982, the feeling on the part of the private industry was that the Commerce Department's handling of the issue, although it may not have been exactly what they desired and wanted, but that it was in good faith, or they felt that it was in good faith.

They thought the penetration figures which were available in April, May, and June clearly showed the injury, and they felt that action should have been precipitated much sooner than it was, but in an attempt to getting to the problem that Commerce at least acted in good faith, they feel.

They also feel that at least a month or two prior to the January filing of the cases that those cases should have been filed at that time.

But, again, don't allege any issues of bad faith although they don't feel it was handled to their dissatisfaction.

The real issue of contentions, and I don't even see why it was raised by Mr. Baldrige before the committee, although I do think he was again expressing an honestly held opinion, a sincere opinion, because the newspapers were full of it, and that was the dissatisfaction over the suggestions made during negotiations over the treatment of certain German coal subsidies and British direct grant as subsidies. The industry feels that they definitely were handled in a political way after that, and that it was not proper and it was not the right way to proceed. I happen to share that feeling with them.

Incidentally, as I explained to Mr. Baldrige after the hearing was over, the recommendations that were made to me came from foreign governments, because the attempt was made to talk to me to try to talk to some of the steel people to relax and recant, so that this negotiation between Commerce and some of the foreign nations involved could take place. Everybody personally loves Mr. Baldrige. They think he is a nice fellow. I never met him before.

Mr. **Frenzel**. I thank the gentleman for that statement. I think it is fair to say that a number of the people we all talked to thought steel companies were a little hardheaded on their requests in the same negotiations.

The gentleman should be aware of that.

Mr. Chairman, I want to thank the witness for his testimony.

Mr. Niskanen, are you familiar with the report done by the Congressional Budget Office on this matter?

Mr. NISKANEN. Yes, I am, and I wish to commend it to you. They have approached this issue in a somewhat different fashion than we have, and their conclusions are also somewhat different, but are clearly attributable to identifiable differences in assumptions.

I think that the comment that Congressman Brodhead made earlier is inappropriate to the extent that the number of people approaching this same issue are coming up to much the same kinds of conclusions, at least if they start with the same starting point.

That, I think, should lend some credence to these numbers.

Mr. FRENZEL. I think it does as far as I am concerned. I have a query, however. Does your analysis include the bill as introduced or the bill as amended?

Mr. NISKANEN. The estimates presented in my testimony are specific to the revised bill, the Ottinger substitute bill.

Mr. FRENZEL. Specifically, your estimate of a new average price of a new car is 470 bucks against Ms. Rivlin's 333.

Do you care to comment on the reasons for those differences?

Mr. NISKANEN. Yes. Their $333 number is an assumption. Ours is very largely a model result. They start with that estimate. We end with it, and so I think that our number in this particular case is more likely to be representative of the effect of the bill.

Mr. FRENZEL. Did you do the work for Mr. Baldrige's testimony today, or did he develop those numbers independently?

Mr. NISKANEN. The numbers that he presented were specific to the earlier bill and were based in part on work that we had submitted through an interagency group at that time.

Mr. FRENZEL. I thank you. You indicate that the cost of each new job created is plus 100,000 bucks in prices alone.

Mr. NISKANEN. That is correct.

Mr. FRENZEL. And then you later talk about the tradeoff for the new jobs created, and whatever reverberations that has in the economy, and then it works its way down to $60,000?

Mr. NISKANEN. The $60,000 number is net, is a net number.

Mr. FRENZEL. The $100,000 is gross.

Mr. NISKANEN. Is gross, that is correct.

Mr. FRENZEL. It is gross.

Mr. NISKANEN. That is right.

Mr. FRENZEL. In my judgment, it seems to me that your testimony simply corroborates other studies and confirms that this kind of trade policy is utter folly, and if we are looking for a new way to shoot ourselves in the foot, if we have got any foot left, this is a good way to do it.

Is there any redeeming characteristic about this bill that you could find?

Mr. NISKANEN. If I were an unemployed autoworker, my views might be different.

Mr. FRENZEL. Of course, if you are an unemployed auto worker under this bill, which doesn't take effect until 1984, nothing good can happen to you for 2 years, but if you are in some other category of employment, which is exporting, as soon as we pass the bill our trading partners can do it to you in 2 days.

Mr. NISKANEN. That is correct. I also want to point out that only a small part of the total job increase that would be a consequence of this bill is likely to take the form of rehiring the present unemployed.

A substantial part of the job increase would be a consequence of the Japanese assembly plants, additional jobs in making radios and air-conditioners and so forth, and in the supplier chain.

The auto companies themselves have something like 220,000 workers on indefinite layoff. Our estimate is that the number of additional jobs in the U.S.-owned auto industry would be less than 10,000 people.

Mr. FRENZEL. Agreed, and so it really isn't going to give much consolation to the unemployed auto worker.

Mr. NISKANEN. No.

Mr. FRENZEL. One of the things I noticed about your study is that you assume that some of the major Japanese automakers will move their assembly, at least, to the United States.

Secretary Baldrige seems to have a contrary opinion. I am sure we will get as many of them in here to testify and try to find out, but what happens to your analysis if these guys tell us they withdraw under the circumstances?

Mr. NISKANEN. The price effect, the absolute price effect on consumers would be larger. The job effect would also be larger, but the price or the consumer cost per job would be roughly the same.

Secretary Baldrige's conclusions were specific, again, to the earlier bill, and our joint analysis of the earlier bill suggests that it would probably not lead to any Japanese assembly here.

The somewhat more relaxed provisions of the Ottinger substitute, however, we believe are likley to lead to some assembly here by the three leading companies.

Mr. FRENZEL. We will try to get some of those people to tell us, and we will be able to test those assumptions, but I thank you for spelling it out for us so that we can make the necessary adjustments.

Mr. NISKANEN. Surely.

Mr. FRENZEL. Again, thank you for your testimony.

Mr. Chairman, I yield the balance of my time.

Chairman GIBBONS. I want to thank you, also, for what I think is a very conservative analysis. During the summer recess, I read extensively on this subject. The reason I gave you that preface is that I can't remember exactly what document I read it in. Some document I read, and perhaps you have reviewed it, said or estimated that the price differential between a Japanese car and a U.S. car, comparable car, was around $1,800 per unit.

Have you seen anything like that?

Mr. NISKANEN. Yes. The most detailed study of this has concluded that the price differential, as of a year or so ago, was around $1,400.

Mr. FRENZEL. $1,400.

Mr. NISKANEN. There has since been a weakening of the yen, which might increase that number. I think there is reason to suspect whether the price is that large, however. If you work backward from the annual financial statements of the Japanese companies, there is no way to get that big a price difference from their financial records unless they are enormously subsidizing their cars everywhere else in the world, because a $1,400 price difference specific to the U.S. markets would lead to much higher profits than they report in their annual statements.

I think there is a substantial price difference on the smallest cars, but I would be somewhat suspicious of numbers even as large as $1,400.

Chairman GIBBONS. The reason I asked you this is because you say that it will only increase U.S. prices by $470 per unit on an average.

Mr. NISKANEN. Correct.

Chairman GIBBONS. And that is a very modest figure when compared to, say, $1,400 or any reasonable figure. Obviously the Japanese do have some advantage on a cost basis. I think one analysis showed that there was about a $600 difference just on the rate of labor pay, to say nothing of the productivity because of the tools and things like that. I would think that $470 is a very modest figure, because the labor differential on an hourly basis is around $600.

What is wrong with my reasoning on that?

Mr. NISKANEN. I think it is quite plausible that the price increase may be more than that. Let me give you some background of the $470 estimate.

Chairman GIBBONS. Yes, because I think $470 is really stating it on the downside.

Mr. NISKANEN. Our estimate is that the price of Japanese vehicles would increase by about $1,000, and the price of U.S. subcompacts and compacts would increase between $300 and $400, and U.S. larger cars would have essentially no price change or very little.

The $470 is an average weighted by the existing market share in those five categories.

Now, as I explained earlier, the one most sensitive assumption that we have made is that the U.S. manufacturers, in response to this law, would increase their own prices in the same proportions as the increase in their volume, but that leads to a situation where the Japanese prices would be increasing by about $1,000 a car, and U.S. prices for comparable cars of a $300 to $400 increase.

An assumption that would be much more consistent with the history to date is that U.S. prices would increase by the same dollar amount as the Japanese prices.

Chairman GIBBONS. It always has. I can't see why you came up with such a modest $470.

Mr. NISKANEN. Because of the obvious concern about our analysis in this area, I think that in several cases, we have bent over backward to make this bill look attractive.

Mr. BRODHEAD. Would you yield?

Chairman GIBBONS. Go ahead, Mr. Brodhead.

Mr. BRODHEAD. Just on that point, Mr. Chairman, what you and Mr. Niskanen are saying, is somewhat at variance with what Ambassador Brock was saying this morning.

I don't know that he was citing any figures, but he said that the experience of the recent past is that the Japanese cars, since the voluntary restraint agreement, they are importing more high-priced cars, and that the American companies are keeping the prices down on the small cars, and that the American companies are below now on the smallest cars, and are more competitive, so in that experience at least, if what the Ambassador said is correct, and it is sort of my understanding, I don't have any figures to back it up that that is what is happening, it is somewhat at variance with what you are saying here, is it not?

Mr. NISKANEN. No, not at all. It is completely consistent with what I am saying. The Japanese have been the effective price leaders at the smallest end of the market. The effect of the voluntary restraint agreement has caused an upward shift in their mix of cars, and has increased this higher value, the price of their higher valued cars and has dropped the price of their lower value cars.

That has disciplined the U.S. price in that regard. That is going to be an understandable consequence of any kind of quantitative restraint, and would be the case here as well.

One of the issues of quotas, whether they are in the form of voluntary export restraints or formal quotas, is that a large part of the benefits from such quotas, accrue to the exporting company, because of the opportunity to charge a higher price for those vehicles which penetrate what has been the more profitable part of the American market.

Chairman GIBBONS. In other words, if we were smart protectionists, we would just increase the duty and put that money in the U.S. Treasury.

Mr. NISKANEN. Correct.

Chairman GIBBONS. And cut off the flow of cars that way, rather than transferring the wealth to the Japanese; is that right?

Mr. NISKANEN. Correct.

Chairman GIBBONS. And if your figures are attackable on any basis, it is that they are too conservative rather than too generous as far as $470 is concerned?

Mr. BRODHEAD. If you want to offer that duty increase bill, Mr. Chairman, I will cosponsor it with you.

Chairman GIBBONS. It would at least show we had some intelligence about what we were doing, that we weren't really trying to commit hara-kiri.

Mr. FRENZEL. Breaking our standards.

Chairman GIBBONS. At least we would be keeping our money in the United States. This bill exports a lot of our wealth the way it will work.

We have to go vote.

Mr. FRENZEL. May I ask a question?

Chairman GIBBONS. Sure.

Mr. FRENZEL. It is perceived around here that the average wage in automobile manufacturing in the United States is roughly $22, our average wage cost. Is that somewhere near correct?

Mr. NISKANEN. Total labor cost per hour is in the $22 to $23 range for, I think, Ford and General Motors. With the Chrysler contract, I believe they are about $2 an hour lower than that until this latest contract, and I don't know what the terms of that contract are.

Mr. FRENZEL. It is also perceived that the average cost per hour of Japanese labor is approximately the average wage cost in manufacturing in the United States, that is somewhere in the $10 to $12 range; is that correct?

Mr. **Niskanen**. It is important to compare total labor compensation with total labor compensation, and not compensation with wages. Automobile wages are about, I think, $13 or $14 an hour. It is their total labor costs that are $22. I think the total labor cost per hour in Japan is more like our wages per hour.

Of course that requires correction for changes in exchange rates, which can change that mix. The relevant comparison, I think, Congressman, is not between United States and Japanese wages any more than between United States and Bulgarian wages.

It is between the labor cost per hour in the auto industry and the average of American industry. Auto industry labor costs are about 60 percent higher than average U.S. industrial labor costs.

That is the key labor problem of the auto industry.

Mr. **Frenzel**. That cost, then, is around $14 United States?

Mr. **Niskanen**. Yes.

Mr. **Frenzel**. Manufacturing?

Mr. **Niskanen**. Yes.

Mr. **Frenzel**. I have some difficulty convincing my constituents at home, who are making $10 to $14 an hour, why they should pay for a car that is made by $22-an-hour steelworkers and automobile workers.

Mr. **Niskanen**. I would have your same problem.

Mr. **Frenzel**. Thank you.

Chairman **Gibbons**. We will resume immediately after the vote with the Department of Agriculture and Department of Transportation.

We thank you very much for your very fine testimony.

Mr. **Niskanen**. Thank you, Mr. Chairman.

Chairman **Gibbons**. And your patience in staying with us all day.

[Recess.]

Chairman **Gibbons**. We will resume with representatives of the Department of Agriculture and Department of Transportation.

Let me explain that Mr. Buckley had to meet with Secretary Shultz and therefore is not available.

Mr. **Frenzel**. I assume that it will be possible for us to submit questions to Secretary Buckley.

Chairman **Gibbons**. We are going to have Mr. Shultz or Mr. Buckley back. We are not going to miss a soul.

Gentlemen, would you like to move more to the middle of the table. We want to keep this whole hearing balanced.

Mr. **Tracy**. It is appropriate we were sitting on the right, Mr. Chairman.

Chairman **Gibbons**. From up here, it looked like you were on the left.

Mr. **Tracy**. Not after we speak.

Chairman **Gibbons**. Mr. Tracy, why don't you go first.

STATEMENT OF ALAN TRACY, DEPUTY UNDER SECRETARY FOR INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS, DEPARTMENT OF AGRICULTURE

Mr. **Tracy**. Mr. Chairman, it is a pleasure to appear before your committee again. I am here to represent the Department of Agriculture and to concur with the views you have already heard from across the administration that we strongly oppose this legislation, H.R. 5133.

We agree with Ambassador Brock's report that the bill "is the worst threat to the international trading system and our own prosperity to be put before the Congress in a decade."

In terms of agriculture, passage of this legislation would be a disaster. U.S. farmers, who depend on export trade for one-fourth of their income and as an outlet for the harvest from two-fifths of their cropland, would be severely damaged, particularly in their two leading markets, Japan and the European Community. So would business throughout rural America.

This legislation would severely restrict exports of these two trading partners at the very time we are pushing extremely hard to liberalize trade in their markets, and on a worldwide basis as well.

Passage of this bill would gravely undermine our negotiating position. We would be laughed out of the GATT Ministerial in November, which the United States has looked upon as a means to take concrete steps to improve the climate for liberal trade.

The legislation violates our agreement under the General Agreement on Tariffs and Trade [GATT], and its passage would almost certainly lead to retaliation by Japan and EC.

·This would put at risk some $15 billion yearly in U.S. agricultural exports to these countries.

And I might add would damage our negotiating efforts with other countries around the globe.

These are some of the consequences of retaliation: Overall, it is estimated that the loss of U.S. jobs would be in the 25,000-30,000 range for each $1 billion in agricultural exports lost.

Japan is our largest single country market for farm products with the total reaching $6.6 billion in 1981. It is our largest feed grain market and is one of the top markets for wheat and soybeans as well.

An estimated 1 of every 20 acres in the United States produces for the Japanese market; more area is planted for the Japanese market than in Japan itself.

Japan is a reliable customer and we are a reliable source of agricultural products, but we do face strong competition from other agricultural exporting nations such as Canada, Brazil, Argentina, and Australia.

Japan could retaliate against a devastating blow to its auto market by shifting some of its purchases to those competing suppliers.

Although some might argue that the loss in U.S. farm exports to Japan would be offset in the short term by a diversion of trade to markets left unfilled by our competitors as they move to meet greater Japanese demand, the long-term loss would be great.

Competitors would expand production to meet both their traditional and expanded Japanese markets and the U.S. share of world markets would decline.

We have been continually pressing the Japanese for liberalization of their import structure, particularly the system of quotas, high tariffs, and other nontariff barriers.

Negotiations are scheduled in October for beef and citrus quotas and we do not want to jeopardize progress at these talks.

The situation would be equally distressing with respect to the European Community, which imported a total of $9.1 billion in agricultural products from the United States in 1981.

Together, Japan and the European Community received 36 percent of our total agricultural exports.

The European Community has been seeking for nearly 20 years to overturn its commitments in GATT to import oil seeds, oil cake, and nongrain feed ingredients such as corn gluten, free of import duties and restrictions.

This legislation may provide exactly the excuse needed by the European Community to restrict these imports.

I just returned from Europe myself this week, and I know that these items are under discussion there.

In 1981, the European Community's imports of oil seeds, oil cake, and nongrain feed ingredients total $4.5 billion. We export over half of our soybean and soybean products and the European Community buys nearly half of these exports.

We are currently engaged in several GATT cases against the EC export subsidies and related agricultural policies. We do not want to lessen the pressure on the Europeans to change trade policies, which affect the entire international agricultural trading system.

That, Mr. Chairman, is a brief review of the consequences to agriculture that could result from H.R. 5133.

Thank you for the opportunity to testify. I will be happy to respond to any further questions.

Chairman GIBBONS. Now the Department of Transportation.

STATEMENT OF MARTIN CONVISSER, DIRECTOR, OFFICE OF INDUSTRY POLICY, DEPARTMENT OF TRANSPORTATION

Mr. CONVISSER. Mr. Chairman and members of the subcommittee, I am pleased to be here today to provide the views of the Department of Transportation on H.R. 5133.

The Department of Transportation fully concurs with the statements of Secretary Baldrige, Ambassador Brock, and the other administration officials who have preceded me regarding the overall effect of the proposed legislation on the economy and on the U.S. trade position.

We are also particularly concerned about the potential for job losses in transportation industries caused both by reductions of automobile imports under the domestic content restriction and by possible reductions in U.S. exports from retaliation to the restriction.

However, since the bill would place responsibility for administering the act in the Department of Transportation, in my brief statement today I would like to concentrate on the special problems that administering the domestic content requirement would create for the Department, and for the automobile and related industries.

In brief, we believe that the workload of the Government and the industry in computing and verifying the domestic content ratio for each manufacturer, as required by the proposed legislation, would be extremely burdensome and intrusive.

By comparison, in dealing, for example, with motor vehicle safety and fuel economy—two areas where the DOT has considerable regulatory experience—we are concerned with the physical characteristics of the final product.

It is possible to determine the fuel economy rating or the safety compliance of a particular car for at least a model year by testing one or a few sample vehicles.

Verifying the domestic content, on the other hand, would require tracing the source of all the materials and all the components in a vehicle, where there are literally thousands of suppliers involved, and where sourcing may change from day to day.

If we are to do a thorough job of determining domestic content, we will be dealing not only with the dozen or so manufacturers who sell more than 100,000 vehicles a year in the United States, but with the 40,000 or more large and small firms in the supply network.

Many of these firms supply more than one manufacturer, and many use materials or parts which, themselves, are imported. The bill asks the Department to rule on how to allocate these foreign and domestic components of each supplier among manufacturers for purposes of determining final domestic content.

I do not know precisely how we would rule, but I do know that it would not be simple or easy and that we would inevitably add to the bureaucratic burden on Government and the industry.

Every manufacturer and every supplier firm would have to keep track of the domestic content of all the parts and material it uses and of all the products it delivers.

To verify the reported domestic content, the Department would have to pry into proprietary purchase, production, and sales records of at least a significant fraction of those firms.

The firms and the Department would have to do this on a real time basis because the bill provides that each year's compliance with the domestic content requirement determines the next year's allowable imports.

In short, recordkeeping, data collection, and paperwork burdens on industry and the Government would be increased, and the Government would need to be a more intrusive presence in the automobile industry and its supply chain.

That concludes my prepared statement. Thank you once again for this opportunity to present our views to the committee.

Chairman GIBBONS. I thank you. From the agriculture point of view, it is possible that we could lose more than $10 billion worth of trade by this bill?

Mr. TRACY. It is very difficult to quantify, Mr. Chairman, but I don't think that such a figure would be out of reach, given a period of time.

I think over enough years, it could be significantly higher than that.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Are you Mr. Tracy?

Mr. TRACY. Yes.

Mr. BAILEY. Mr. Tracy, I understand the objections to this legislation. I said many times today in an ideal situation, it is just not a good thing. I think everyone understands that, but we are dealing in a real world and dealing with issues like making examples, et cetera, et cetera, et cetera, and you are just left with nothing.

What do agricultural exports amount to? I think we had figures today, $25 billion or so yearly?

Mr. **Tracy**. The gross exports of agricultural products were in the neighborhood, for fiscal year 1981, of $43.8 billion.

Mr. **Bailey**. And you think that you are placing those exports at risk with this legislation because we are talking about trade wars?

Mr. **Tracy**. Absolutely.

Mr. **Bailey**. I am going to tell you, Mr. Tracy, what I think about that logic. I can understand Mr. Brock feeling that he could be embarrassed, Mr. Baldrige feeling they could be embarrassed, because it would represent a dramatic change in American policy. I think that is a sincere problem on their part.

They are afraid of egg on their faces, of looking hypocritical, and they are concerned. They are genuinely concerned about the American face out there, and so am I. But if I wanted to look around the world in terms of a right to respond, how can you say this?

Looking at the Japanese system, overall, or some of the European systems, for example, are they more open than us? Are they less open than us, taking in overall? Are they?

Mr. **Tracy**. In terms of agricultural trade, which is the only area that I really feel qualified to speak to here, we feel that our system is more open than either that of Japan or the European Community.

Mr. **Bailey**. I agree with that, but your statement went beyond just the agricultural thing. Our system is more open.

Mr. **Tracy**. That is correct.

Mr. **Bailey**. I suppose, then, that when it comes to justifying some kind of action of this sort, that we must have some room to justify it. Are we so afraid of a trade war that we are going to be destroyed by all our trade partners if we pass this bill?

They are going to gang up on us? It looks to me like the world is ganging up on Japan. Japan had better get smart quick, it seems to me.

Mr. **Tracy**. They have barriers in markets in the European Community and Japan to our agricultural trade.

Mr. **Bailey**. That is right.

Mr. **Tracy**. We are busy negotiating to attempt to reduce those barriers. A meat-ax approach is not going to help.

Mr. **Bailey**. Mr. Tracy, how long have we been negotiating to reduce those barriers? I just received in my office yesterday, and I read every darn one of them, 100 questions about Japanese-American trade.

Did you read that little blue book? Did you get a copy of it, per chance?

Mr. **Tracy**. I am not sure.

Mr. **Bailey**. The Japanese sent it out. I read the book. I was intrigued by their discussion.

Mr. **Tracy**. Oh, yes.

Mr. **Bailey**. Do you know what I am talking about?

Mr. **Tracy**. Yes.

Mr. **Bailey**. Did you read the answer on beef? Did you read the answer? You have got to read it.

Mr. **Tracy**. I skimmed the book.

Mr. **Bailey**. Mr. Tracy, you have got to read it. You have got to read the explanation for why we cannot get more beef into Japan, and this is a Government publication. It is an insult to a fourth-grader. You have got to read it.

Do you really think there would be that much retaliation? You sincerely believe that in your heart, that somehow there is going to be a massive retaliation against American agricultural products? I understand practically every country on Earth, to some degree, or most countries on Earth, to some degree, protect their agricultural products.

I know I listened to Mr. Frenzel, who is very learned, and I listened to my chairman, Mr. Gibbons, who is very learned, when we met with some Europeans, and one of the discussions was the difficulty of every country protecting its agriculture to some degree.

In fact, we subsidize a lot of our agriculture, right? Am I correct, technically speaking, we do?

Mr. **Tracy**. We provide some price support for price stabilization. We do not subsidize exports for agriculture.

Mr. **Bailey**. I didn't say subsidize exports. We subsidize our agriculture in this country, our agricultural production. I don't think there is any question about it. Don't we do that?

Mr. **Tracy**. I would prefer not to be pinned down to that term because of the confusion with subsidies of exports.

Mr. **Bailey**. You don't have to worry about pinning me down, Mr. Tracy. I know the difference. I think it is obvious we subsidize our agriculture in this country. I am not ashamed of it. I think it is a good idea.

I don't want to run this out. The chairman has been so good to me today. I don't know how he has kept his patience up, quite frankly.

I would just say this. I just do not think you are going to get, with all due respect, the kind of retaliation you are talking about.

As a matter of fact, somebody has got to get across to these folks somehow, to some of these countries, that we mean what we say when we are trying to set up this free-trade model. That we really mean it. And we just have been negotiating ourselves into weak positions.

Now we are in an economic position where, you know, the theme that runs through everything all you people say? Your fear of a trade war. I had a very brief discussion, myself and two other Members of Congress in the previous administration, with Frank Moore.

We were raising the question of why we could not do more with some steel and manufactured products, et cetera, downstream dumping, all kinds of concepts we would like to do something about.

He said they feared a trade war. Are you afraid of a trade war with the Japanese? Why don't you put that on the record if you are.

Are you afraid of it?

Mr. **Tracy**. Am I afraid of a trade war with the Japanese? I am concerned about the possibility of retaliation against our existing export sales in agriculture with the Japanese——

Mr. **Bailey**. Afraid of fire fights with the Japanese in trade?

Mr. **Tracy**. And losing opportunities for further access to their markets, which we are in the process of very difficult negotiations——

Mr. **Bailey**. Have you said that somewhere before? It just came right off the top? I admire you. I disagree with you.

While certainly I think there would be a lot of pressure and a lot of reaction, I think to talk about this thing to the extent you have is really overdoing it a little bit.

And I think we are suffering an awful lot of resistance right now that we shouldn't be. I would have loved to have heard you come up with some solutions on how to deal with those along with this, because people are getting upset with it, you know.

Mr. **Tracy**. We are working very hard on some of those resistances. One example is the beef quotas which are highly restrictive. We have excellent potential there. We did manage to get the Japanese to agree to move those negotiations up by 1 year. They are due to start within 1 month. We certainly hate to jeopardize that.

Mr. **Bailey**. I hope they do a better job than they did with cigarettes. And I bet you do, too. You get my point.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman.

Mr. Tracy, you indicated that we had quite an open agricultural market.

Mr. **Tracy**. I was referring to it in relative terms. We do have some restrictions as many countries do, but relative to Japan and relative to Europe, with its extremely high variable levy system, yes, our system is relatively open.

Mr. **Frenzel**. Yet those restricted markets accept 36 percent of our agricultural exports. We are negotiating with the Japanese on beef restrictions. We have beef restrictions, too, don't we?

Mr. **Tracy**. We have in place a system of quotas which currently is nonrestrictive. In other words, the imports we have had have been lower than the quota.

Mr. **Frenzel**. Yes, but it is in place, is that not correct? We have barrier restrictions against cheeses. We pay a price for all the dairy product anybody can produce in this country.

I guess we heard from the chairman how tough we are trying to keep Mexican tomatoes out, Canadian potatoes. Life is not so simple for our trading partners.

All is not black and white. We have some restrictions, too.

Mr. **Tracy**. Yes we do have some restrictions.

Mr. **Frenzel**. Well, I agree. And while I believe that the United States, with possible exceptions, is one of the most open markets in the world, it is certainly not open in a nonrestricted sense.

And I agree with you that there are opportunities for us to continue to negotiate greater opportunities in Japan, as well as the European Community.

But I further agree with you that there is not any way we are going to do it if we pass a bill like this. I read here that we import, we export to the European Community one-quarter of all the soybeans we produce in this country, more or less?

Mr. TRACY. That is correct.

Mr. FRENZEL. That is a whole heck of a lot of soybeans. And except for the fact that we were not a reliable supplier to Japan in the mid-1970's, we export, I mean we exported about half the rest of it to them.

Mr. TRACY. That is correct.

Mr. FRENZEL. Although we encouraged them to look elsewhere, when we made a mistake. I think you are dead right. I really believe that American agricultural producers have the greatest amount to lose in a trade war or a trade skirmish, or even a minor border dispute.

You point out here that we have to export huge proportions of what we grow in this country. It is simple, particularly for our friends in the European Community, to restrict admission of those kinds of products.

That, one-quarter of all the soybeans we grow, which is, you say, $4½ billion worth?

Mr. TRACY. That is approximately correct, to the European Community.

Mr. FRENZEL. That is going to be in jeopardy anyway when the Spanish accession occurs, if it ever occurs, is it not?

Mr. TRACY. The Spanish accession, and the problem they have of letting Spain in and supporting in some way the Spanish olive oil producers is leading the European Community to look at the possibility of increasing their tax on vegetable oil, among other things, partly to support the price so that they can support those Spanish farmers, and partly to raise revenue for further direct transfers to those farmers.

They would love to have an excuse to go ahead and unbind the GATT binding on duties on soybean products.

Mr. FRENZEL. How about corn gluten and feed, that too?

Mr. TRACY. Certainly. We have a zero tariff binding—it is possible for them to do so. However, we would have measures to compensate us for the loss.

Mr. FRENZEL. We would be hanging from a slender reed if we had already passed this kind of legislation.

Mr. TRACY. I think we would.

Mr. FRENZEL. If they suddenly decided all their feed had to be 90 percent local content, it would be pretty hard for us to argue, would it not?

Well, I think your testimony is brief, but it is good. And I think you are dead right to be darn nervous about the constituency that you are trying to support.

At the time when we are trying to increase exports, we are considering a bill that would help decrease them in the most likely case.

If I were an employee of the Department of Agriculture, I would be darn worried about it, too. I am delighted that you have given us the advantage of your testimony.

Is it Mr. Convisser?

Mr. CONVISSER. That is correct.

Mr. **Frenzel.** I raised the question earlier today that one of the problems with this bill was that it was written to avoid our committee, and so it went to another committee. And therefore involved your Department in an area where you have no persons and personnel.

I wonder if you have an estimate in your Department as to how much extra personnel it would take you to administer this law?

Mr. **Convisser.** We have not tried to develop a concrete estimate. But we do know it would take a substantial number of people to collect the data and enforce the law.

Mr. **Frenzel.** Well, it takes the military about a million dollars to go into all of our defense contractors' plants and live with them and watch them and see that they are not doing anything contrary to law or good public policy. I assume that you would have to put your people out in the field to verify the figures that you are receiving from these folks.

Mr. **Convisser.** I think we would.

Mr. **Frenzel.** I further presume that these guys would have to have some experience, so you would have to hire them expensively.

Mr. **Convisser.** I imagine so.

Mr. **Frenzel.** All that to save a few thousand jobs in 1985?

Mr. **Convisser.** That is the purpose of the bill, sir.

Mr. **Frenzel.** Well, I thank you.

I am delighted to learn that the Department of Transportation has no territorial missions.

Mr. **Convisser.** We certainly do not, sir.

Mr. **Frenzel.** And is not anxious to steal turf from its brethren on the Cabinet.

Thank you very much. I think your testimony—oh, I have one further question.

In the bill you are required to make some fancy study on parts of manufacturers in the United States. Secretary Baldrige thought he was well qualified to make that survey. Do you think that he is better qualified with the people that he has through his division of the automotive sector, or do you think you could handle that readily without extra cost?

Mr. **Convisser.** Well, as I am sure you know, the Departments of Transportation and Commerce agreed some time ago to shift certain responsibilities with respect to the Chrysler Loan Guarantee Board and the report to the Congress on the automobile required by that statute. That responsibility now resides with the Department of Commerce.

I think they would be well qualified to undertake study required by H.R. 5133.

Mr. **Frenzel.** As far as you know, you would prefer to have them do it?

Mr. **Convisser.** I believe that is likely.

Mr. **Frenzel.** So you don't see much sense of having your Department involved in this business at all?

Mr. **Convisser.** Well, we would leave the determination to the Congress if the bill were to pass. But we don't have any ambition for it.

Mr. **Frenzel.** Thank you very much. Neither do I.

Mr. **Gibbons.** Mr. Pease.

Mr. **Pease**. Thank you, Mr. Chairman.

I think my questions are directed to Mr. Tracy.

Mr. Tracy, in the fourth paragraph of your testimony you say this legislation would, underline would, severely restrict exports of these two trading partners at the very time we are pushing extremely hard to liberalize trade in their markets.

Do you mean this legislation would severely restrict exports of those partners to the United States? Is that your statement?

Mr. **Tracy**. Yes, sir.

Mr. **Pease**. Why do you assume it would restrict exports from the European Community to the United States?

Mr. **Tracy**. I am not—I wasn't aware that there was a question about that. They do export a considerable number of automobiles to the United States.

Mr. **Pease**. Under the terms of the bill that came out of the Commerce Committee last year, all the European producers could easily meet the requirements of this bill. Why would it restrict their exports to this country?

Mr. **Tracy**. At some cost to them, perhaps.

Mr. **Pease**. It says no cost to them according to the CBO.

Mr. **Tracy**. Nonetheless, it would certainly damage our negotiating stance with them. We are attempting to achieve greater access in their markets.

Mr. **Pease**. I can understand that point. Do you retract your statement as far as the European Community is concerned?

Mr. **Tracy**. My understanding is that it would still potentially affect those exports.

Mr. **Pease**. Can you supply me with your rationale for that?

Mr. **Tracy**. It is my understanding, Mr. Pease, that there would be some constraint on their exports to us.

Mr. **Pease**. Of automobiles?

Mr. **Tracy**. That is correct.

Mr. **Pease**. I wish after the hearing you would check over your understanding and tell me in what way. That is not what CBO tells me.

Let's move along then. In the last paragraph on page 1 where you say passage of the legislation would almost certainly lead to retaliation by Japan and the European Community. If, as CBO tells us, this would not cut down on the European exports of automobiles to the United States, why would the passage of the bill certainly lead to retaliation by the European Community?

Mr. **Tracy**. As I pointed out in my discussion with Congressman Frenzel, the European Community would be delighted to have an excuse to impose a tax on soybeans. At this point in time, I am sure they would view this as such an opportunity.

Mr. **Pease**. It says in the first paragraph of page 2 that overall it is estimated that the loss of U.S. jobs would be in the 25,000 to 30,000 range for each billion dollars of agricultural exports lost.

We were given the same 25,000 to 30,000 job figure by Secretary Baldrige this morning for the entire economy, including capital goods and that sort of thing. I would have thought, considering the enormous productivity of American farmers, that the labor intensive nature of agriculture would be less than that of capital goods.

Is this 25,000 to 30,000 job figure, does that specifically apply to agriculture, or could you be picking up an economywide figure?

Mr. TRACY. This figure specifically applies to agriculture. It is based on a study done by Michigan State University.

Mr. PEASE. That is on-the-farm and off-the-farm jobs.

Mr. TRACY. That is correct. It includes transportation, handling, et cetera.

Mr. PEASE. At some point I think you say that 1 out of 3 acres of farmland in the United States is devoted to export sales?

Mr. TRACY. It is actually I think 2 out of 5 as stated in the testimony.

Mr. PEASE. Two out of five?

Mr. TRACY. Yes; it is approximatley 38 percent according to figures we had for 1980. Either one is close. An approximation.

Mr. PEASE. You say about 36 percent of our total agricultural products go to the European Community and Japan; 36 percent of 38 percent is about 14 percent. If we lose half of our agriculture sales to the European Community and Japan, that would mean the overall effect would be about 7 percent?

Mr. TRACY. It would be much higher than that. It would affect the price of the entire market involved, both internationally and domestically.

Mr. PEASE. If Europeans tried to buy grain representing half their supply from somebody else, or Japan, would that not drive up world prices, make it advantageous for our firms?

Mr. TRACY. It would drive it down here and would give benefits to other producers.

Mr. PEASE. Is there a worldwide price for grain?

Mr. TRACY. In general, yes. But times when people are seeking alternative suppliers, there have been special benefits that have accrued to other producers, such as to the Argentinians during the Russian embargo.

Mr. PEASE. The prices went up there, did they not?

Mr. TRACY. The Argentinians received, imposed in effect a special export duty which increased the price of their commodities.

Mr. PEASE. I don't have any other questions, Mr. Tracy. But I would appreciate an answer from you on why we could automatically expect restrictions of exports of European cars to the United States.

Mr. TRACY. We will clarify that for the record.

[The information follows:]

Contrary to the CBO's findings, that separate analysis within the Administration indicates that the bill as amended could have an impact on European automobile exports to the United States. While a firm such as Volkswagen may be able to comply with the standards set forth within the bill, it is still unclear whether other smaller European manufacturers, like Mercedes or Volvo, would not be affected. Thus, there still remains the potential for this legislation as written to result in restrictions of some types of European automobiles to the United States.

Mr. PEASE. Thank you.

Thank you, Mr. Chairman.

Mr. GIBBONS. Mr. Schulze.

Mr. SCHULZE. Very briefly, Mr. Chairman.

Thank you, gentleman.

If our goal is to liberalize trade laws internationally, what motivation is there for other countries to go along with this liberalization? They have been the beneficiaries of having protectionism at home and the freedom to penetrate our markets.

Why would they want to change the status quo right now?

Mr. **Tracy**. Well, in the agricultural area, there are various ways by which pressure can be applied.

Mr. **Schulze**. Things which have not been done in the past?

Mr. **Tracy**. I am sure there are alternatives that have not been used to date.

Mr. **Schulze**. New, exciting things we can now use?

Mr. **Tracy**. Well, I don't know how exciting they are. This bill could be construed as having a use in that direction.

Mr. **Schulze**. That is my opinion of exactly what it is. Saying you know we have tried everything else. Two people can play this game and we are no longer going to roll over. I think it is the best thing going. I don't think it is the greatest thing, but it is the only thing that can send that message.

Mr. **Tracy**. Well, Mr. Schulze, while it may be tempting to us from the standpoint of desiring more leverage to work our negotiations, the risks are certainly too great here. This bill is too damaging.

Mr. **Schulze**. In your opinion. I understand your position and where you are coming from. Thank you for your testimony.

Mr. **Bailey**. Mr. Chairman.

Chairman **Gibbons**. Surely, go ahead.

Mr. **Bailey**. Just a couple more followup questions.

Mr. Tracy, let me try to get something straight in my head.

This retaliation that is going to be lodged against us because this bill largely would impact incidentally the Japanese, I don't know if it would even impact anybody else. It is safe to say for purposes of discussion we can assume that. What kind of acreage is available to the Japanese that is marginally productive that they will throw into production in order to make it available for production to replace necessities they purchase in the United States?

Are you saying they are going to go to other world countries to spite us and purchase commodities at higher prices to teach us a lesson?

The Japanese are too smart for that. I don't think they are going to do that. I mean, they are already restricting things that are not necessities.

You know, that maybe they call luxuries. I don't know. Their people like beef. They don't want to lose foreign exchange. They don't let that beef in.

Explain the mechanism to me. I just don't understand.

Mr. **Tracy**. Mr. Bailey, they don't have any significant amount of available acreage to press into further production. They already have high price exports for what is producing. However, if they were to go to our competitors, our competitors respond with their production to the availability of a market. Just as we saw——

Mr. **Bailey**. OK. You are saying what they will do is, they are going to go to somebody else.

Mr. **Tracy**. That is correct.

Mr. **Bailey**. As a result, they are going to replace us. That is what you are saying.

Mr. **Tracy**. That is correct.

Mr. **Bailey**. OK. I think we control about, the last time I looked—please correct me—17 percent of the world wheat market for example—what percentage?

Mr. **Tracy**. It is higher than that. Our share of the world wheat market is higher than that.

Mr. **Bailey**. How much higher?

Mr. **Tracy**. I can give it to you in soybeans. We account for about 70 percent of the world trade in soybeans.

Mr. **Bailey**. How much of that 70 percent did the Japanese buy?

Mr. **Tracy**. We are accounting for 70 percent of the world trade and they are accounting for roughly a fourth of our soybean exports. I suppose they are——

Mr. **Bailey**. They are purchasing 25 percent from us, something like that. Is that what you are saying?

Mr. **Tracy**. Well, I don't know their exact breakdown. They are buying from us and from Brazil.

Mr. **Bailey**. From us and Brazil?

Mr. **Tracy**. In large measure.

Mr. **Bailey**. OK. Do they buy all we produce?

Mr. **Tracy**. No.

Mr. **Bailey**. But they would replace us and they are doing us a favor; they are buying higher priced American soybeans to be nice to us?

Mr. **Tracy**. No, I am suggesting that they would have the option available to them to buy more beans from Brazil.

Mr. **Bailey**. At higher prices, Mr. Tracy?

Mr. **Tracy**. Not necessarily right away. It would depend on how much more they bought over what period of time, but certainly over a period of time they would be able to move a considerable share of their emphasis to Brazil, as they did——

Mr. **Bailey**. You are assuming they would do that as a matter of spite, in other words?

Mr. **Tracy**. May I suggest that prior to the soybean embargo that I believe Mr. Frenzel mentioned earlier in the early seventies we had 90 percent of world trade in soybeans.

Mr. **Bailey**. What happened? Why did we lose that other 20 percent?

Mr. **Tracy**. One serious reason was the Japanese invested in production in Brazil and encouraged that production.

Mr. **Bailey**. That was before we had a domestic content law?

Chairman **Gibbons**. It was the stupidest domestic content. We cut off the supply of soybeans. What would you do if you depended on soybeans? You would go out and plant them every place in the world.

Mr. **Bailey**. Not when the prices were $60 a bushel.

Chairman **Gibbons**. They had 1 bushel up there in the futures exchange and they wore it out moving it around.

That has to go down as one of the bad economic policy decisions we made in a long time. We had almost a monopoly on soybeans around the world. We had the technology, everything else. So we cut off the world supply of soybeans and everybody else started growing them, and they found out they had farmland and they could produce them.

In Brazil they pushed down coffee they couldn't sell. They put in soybeans. The Japanese put the investment in for them.

There is a lot more land in Brazil for growing soybeans. They are able to. It is no idle threat. They can go down there and grow all the soybeans they want. They can run us out of the world market in soybeans.

Mr. **Bailey**. That is similar to what they tried to do with pulp and paper?

Chairman **Gibbons**. No; this is different. This is not the Amazon. This is in the nice rolling, beautiful hills of Brazil.

Mr. **Bailey**. I know where soybeans grow. We even grow a few of them back home.

Chairman **Gibbons**. Beautiful land.

Mr. **Bailey**. How long would it take them to do that, to make that investment to replace that American percentage?

Mr. **Tracy**. They would be able to replace some of it immediately.

Mr. **Bailey**. Then why aren't they doing that now?

Mr. **Tracy**. We are attempting to convince them that we are a reliable supplier.

Mr. **Bailey**. We are attempting to convince them. How does a reliable supplier of soybeans relate to domestic content with automobiles?

Mr. **Tracy**. You asked why aren't they doing it now. They have already done that since the last embargo. They still rely on us for a large share of their soybean imports.

Mr. **Bailey**. No, but I asked for the relationship between domestic content and reliable soybean production here. That is all.

The point I am trying to make is that if the Japanese were to do this with soybeans, first of all knowing the Japanese economy and the way they do business, the way any businessman does business or any commodity flows or works, I just, of course, make the assumption in terms of what that existing market is right now that they purchase what they purchase here because it is a good price to purchase them at.

If they can make an investment somewhere else, I would expect them to do that and make it a little cheaper, that kind of thing. I don't know what world stockpiles in some of these commodities are, I imagine in some cases they are probably pretty high, I am not sure.

I know they pick and choose their products. They restrict some of them severely. They want to quench this desire for beef that the Japanese population has. Why they do that I don't know. I guess because they support their fishing industry quite a bit.

What I am saying to you is, I have a tendency to think it would be very poor economics for them in terms of retaliation to do what you are suggesting that we are doing for retaliatory purposes.

The argument you are making is one that they ought to make.

Mr. **Tracy**. Perhaps I should restate that and put more emphasis on the fact that one reason they continue to buy from us is because we treat them as a valued customer.

Mr. BAILEY. We treat them as a valued customer. We are just the bad guys of the world. That's all. We really are. We are the dummies of the world.

Thank you, Mr. Chairman.

I speak for myself. Present company excluded, incidentally, Mr. Tracy. Thank you.

Chairman GIBBONS. All right, thank you, gentlemen. That concludes our hearing for the day. We will convene tomorrow morning at 9:30, at which time we will hear Congressman Ottinger, the chief sponsor of this bill, and Douglas Fraser, president of the United Auto Workers. We will also hear from other witnesses at that time.

Let me say though for all involved, and I hope Mr. Fraser has someone representing him here, we have a series of votes tomorrow, many of which involve the Ways and Means Committee. We may have a little trouble getting started tomorrow. We will start with Mr. Ottinger. I imagine about the time we get halfway through Mr. Ottinger, the bells will start ringing. We have a number of bills out of this subcommittee and the full committee.

We will be as brief as we can with Mr. Fraser, but it is just one of the facts of life. We are going to have to get up and leave a couple of times.

Is it possible to get a quorum?

The meeting is adjourned. Thank you, gentlemen.

[Whereupon, at 4:35 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Wednesday, September 22, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

WEDNESDAY, SEPTEMBER 22, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen. It is now time for the meeting to commence. We are waiting on our principal witness, Mr. Ottinger, who, as you know, is the sponsor of this legislation. After that we will have Mr. Fraser.

We have one complicating factor this morning. There are a number of bills that have to be voted on on the House floor. Most of those bills are out of this Ways and Means Committee, so we may have to have some interruptions here, for which I apologize to the audience and, of course, to Mr. Fraser and to our friends with the TV cameras.

As soon as Mr. Ottinger arrives, we will proceed.

Good morning, Mr. Ottinger. We are glad to have you here. You may proceed as you wish.

STATEMENT OF HON. RICHARD L. OTTINGER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Ottinger. Thank you very much, Mr. Chairman.

I appreciate being invited to appear today before you to testify on H.R. 5133, the Fair Practices in Automotive Products Act, and I applaud you, Mr. Chairman, for having the foresight to schedule prompt hearings on this bill which was reported by the Energy and Commerce Committee last week.

This legislation is, as you described it last week, Mr. Chairman, a hot potato, but it is also one of the most vital pieces of legislation that has come before the Congress in my recollection. The subject of fair trade in the automotive industry is of vital importance to our Nation's economic health, and to the lives and welfare of 300,000 unemployed auto workers, and 606,000 people who are unemployed in related industries, because of the slump in auto sales.

Mr. Chairman, as of this morning there are 224 members of the House of Representatives listed as cosponsors of my bill. On the Subcommittee on Trade there are four, including two original cosponsors—Mr. Brodhead and Mr. Pease.

On the full Ways and Means Committee, there are 16 cosponsors. Clearly this bill has strong support. It is now endorsed by more than a majority of the Members of the House, and is rapidly gaining proponents in the Senate

Auto imports from abroad, especially from Japan and Europe, have reached critical proportions. Between 1978 and 1981, auto imports from Japan expanded 37.1 percent. Japan's share of our auto market grew from 12.1 percent to 21.8 percent during those years. Beginning this year, Japan captured 25 percent of our market share, boosting the total import share to a whopping 31 percent of our market.

During the last 4 years 606,000 auto-related jobs in the United States have vanished. The increasing market share figures that I just mentioned are a significant cause, and we are in very real danger of losing 42 percent of our current auto-related jobs within the next decade unless steps are taken to address the situation.

Incidentally, this high automobile unemployment results in an estimated $25 billion lost to the U.S. Treasury in taxes that otherwise would have been collected in the last 2 years.

Not only are imported vehicles eating up domestic jobs, but even more insidiously, all five major U.S. auto manufacturers are stepping up this practice of the purchase of parts and components from low wage countries overseas.

In light of the unwillingness of foreign nations to relent in their protectionistic import policies and the intolerable unemployment and loss of automobile manufacturing here, I, for one, cannot sit back and watch without taking action to see that we protect ourselves.

My bill would simply require companies which sell cars here to build a substantial percentage of their vehicles and components here. The legislation, reported out last week as I said by the Energy and Commerce Committee, has been modified somewhat from the bill as I originally introduced it.

One of the major differences is the redefinition of added domestic value, which now provides a complete accounting of domestic costs, whereas the original H.R. 5133 counted only parts and labor for purposes of determining the domestic content ratio.

The omitted costs, depreciation, taxes, interest, utilities, overhead, and so forth, together add up to 25 percent or more of the total costs for a company. This redefinition, put simply, means that a company can include these costs in its domestic content ratio, thereby making it easier for the company to obtain the domestic content required by the bill.

The bill, as passed by the Energy and Commerce Committee, has a lower and smoother schedule of content ratios. While the categories still begin at 100,000 vehicles, the result will be a fairer application of the law. The revised schedule divides a company's sales by 10,000 to determine the content ratio, that is if a company sells roughly 150,000 cars in 1986, their assigned domestic content ratio would be 15 percent, down from 50 percent in the original bill.

In practice, this keeps the U.S. "Big Three" at 90 percent content, and all the U.S. manufacturers today satisfy the requirements of the bill, but it reduces the requirement for all other companies to ratios more readily within their grasp.

A case in point is Volkswagen, which already meets the final requirement for content described under the bill as passed by the Commerce Committee.

Honda is not pushed much beyond its announced plans to step up production in America.

I feel that this fact is important because both of these two companies are engaged in doing what the focus of the legislation requires—encouraging companies to manufacture their cars here in our country.

The start and finish of the 3-year phase-in period have been pushed back a year because the legislation has been some time in the processing. The revised bill would take effect in 1984 and the schedule would be completed in 1986.

The bill has a revised penalty provision. A violator's imports would be cut back by the same percentage as the violator has fallen short of the content requirement. Under the original H.R. 5133, a company's imports would be reduced by 25 percent regardless of the extent or severity of the violation. The bottom line is that the substitute treats all equally, and the punishment fits the crime.

It will present a substantial means for allowing foreign companies to gradually meet the requirements of the bill and reduce their penalties to the extent that they satisfy the requirements of the bill.

In conclusion, Mr. Chairman, each of us realizes that the auto industry plays a key role in the growth and prosperity of every large industrial country.

Because of that, no other major auto-producing nation has ever allowed its own auto production to collapse relative to local sales at the rate we have experienced since 1978.

In the past 20 years, virtually all of these governments have intervened at critical stages to prevent the destruction of their national auto markets—among them are Japan, Germany, France, Italy, and Britain. These countries presently maintain various import restrictions and/or nontariff barriers with respect to the import of automobiles and no action has been taken against them under GATT.

Indeed, 31 countries presently have auto domestic content requirements without there having been any GATT objection. Japan has domestic content provisions which it presently is asserting against the sales of U.S. aircraft to Japan.

Clearly the ideal situation would be to get all of these restrictions removed. Unfortunately our trade negotiators have not been able or willing to do that over the years.

The restrictions have piled up, and we sit there and do nothing. We open our markets just wide open, while the other countries restrict their markets to U.S. exports.

It seems to me that this kind of legislation is just vitally needed to give us the kind of leverage that we need in order to be able to show that at least Congress means business when we go to the negotiating table and try and open up trade to the world.

It is not my desire, as you well know, to see to it that we initiate a trade war and have barriers set up throughout the world against trade, but free trade is not free trade so long as half of the world and the most prosperous nations in the world maintain barriers against our products, and we allow our markets to remain completely open.

Free trade requires an element of fairness, and this legislation seeks to address that critical problem.

During the consideration of H.R. 5133 by the Energy and Commerce Committee, both proponents of this legislation and those who do not favor it rattled off statistic after statistic about how many jobs it will provide or not provide, what the impact will be on the price of a car. Both parties recited laundry lists of those organizations that are for and against local content.

I am absolutely convinced that this will end up with increased jobs in the United States and lower car prices. With respect to prices it will introduce new competition into the U.S. markets, because I think the foreign countries will comply. We are the largest automobile market in the world. They are not going to turn their back on this largest market, and we will see increased competition in the United States that will result in lower prices.

With respect to jobs—U.S. jobs—I think there clearly will be many, many jobs that will be restored, and I think the Congressional Budget Office study on this subject that raises questions with respect to the number of jobs that will be created is grossly in error.

It assumes that the legislation will totally fail. It assumes that all present foreign manufacturers in the United States will pull out rather than that companies will comply with the legislation, and it states no basis for making that assumption.

While I believe that my bill will result in the employment of upwards of 800,000 individuals, and while I don't think that this bill will result in the undesirable side effects that opponents claim, the bottom line is that the United States cannot continue to cling to open U.S. auto markets while our competitors close theirs to us and make off with our sales and jobs, whereas the other countries of the world are protecting themselves against Japanese imports, which have been the largest problem in this area.

The United States cannot continue to play "Uncle Sucker" in light of the practices of Japan, Europe, and others which, while not enforcing auto domestic content laws per se, practice inspection procedures and apply tariffs that exclude our autos and other products from their markets.

The opponents of this legislation speculate about possible retaliation. Yet, as I have indicated, 31 countries have domestic content laws for autos without any retaliation—and all the European countries maintain quotas for Japanese imports without retaliation.

We are the largest auto market in the world, and I just cannot believe that Japan will abandon that market if required to manufacture here.

Japan has not done so elsewhere.

Mr. Chairman, as you know, there are 300,000 autoworkers without a job, and that is a fact. That is not speculation.

The time is short. We are talking about the jobs, livelihoods and the economic survival of an estimated 867,000 Americans and their families. We must act, and we must act now.

I ask that your august subcommittee expedite action on this legislation as quickly as possible. I thank you for this opportunity again to appear.

[The prepared statement follows:]

STATEMENT OF HON. RICHARD L. OTTINGER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, members of the committee, I appreciate being invited to appear before you today to testify on H.R. 5133, the "Fair Practices in Automotive Products Act," and I applaud you, Mr. Chairman, for having the foresight to schedule prompt hearings on this bill which was reported by the Energy & Commerce Committee last week. This legislation is, as you described it last week Mr. Chairman, a "hot potatoe," but it is also one the most pressing issues of the day. The subject of fair trade in the automotive industry is of vital importance to our nation's economic health, and to the lives and welfare of 300,000 unemployed auto workers and 606,000 people who are unemployed because of the ripple effect the auto industry has on related endeavors.

Mr. Chairman, as of this morning, there are 224 Members of the House of Representatives listed as cosponsors of my bill. On the Subcommittee on Trade there are 4, including two original cosponsors—Mr. Brodhead and Mr. Pease. On the full Ways and Means Committee, there are 16 cosponsors. Clearly, this bill has strong support. It is now endorsed by a majority of the Members of the House, and is rapidly gaining proponents in the Senate.

Auto imports from abroad, especially from Japan and Europe, have reached critical proportions. Between 1978 and 1981, auto imports from Japan expanded 37.1%. Japan's share of our auto market grew from 12.1% to 21.8% during those years. Beginning this year, Japan captured 25% of our market share, boosting the total import share to a whopping 31% of our market.

During the last 4 years, 606,000 auto-related jobs in the United States have vanished. The increasing market share figures that I just mentioned are a significant cause, and we are in very real danger of losing 42% of our current auto-related jobs within the next decade unless steps are taken to address the situation.

Not only are imported vehicles eating up domestic jobs, but even more insidiously, all five major U.S. auto manfufacturers are stepping-up this practice of the purchase of parts and components from low-wage countries overseas.

That's the problem. In light of the unwillingness of foreign nations to relent in their protectionist import policies, and the intolerable unemployment and loss of auto manufacturing here I, for one, cannot sit back and watch without taking action to see that we protect ourselves.

My bill would simply require companies which sell cars here to build a substantial percentage of their vehicles and components here. The legislation, reported out last week as I said by the Energy and Commerce Committee, has been modified somewhat.

One of the major differences is the redefinition of "added domestic value"—which now provides a complete accounting of domestic costs, whereas the original H.R. 5133 counted only parts and labor for purposes of determining the domestic content ratio. The omitted costs (depreciation, taxes, interest, utilities, etc.) together add up to 25 percent or more of the total costs for a company. This redefinition, put simply, means that a company can include these costs in its domestic content ratio, thereby making it easier for the company to attain it.

The bill as passed by the Energy & Commerce Committee has a lower and smoother schedule of content ratios. While the categories still begin at 100,000 vehicles, the result will be a fairer application of the law. The revised schedule divides a company's sales by 10,000—that is, if a company sells roughly 150,000 cars in 1986, their assigned domestic content ratio would be 15 percent (down from 50 percent in the original bill). In practice, this keeps the U.S. "Big Three" at 90 percent content, but reduces the percentage for all other companies to ratios more readily within their grasp. A case in point is Volkswagen, which already meets the final requirement for content prescribed under my substitute. Honda is not pushed much beyond its announced plans to step up production in America. I feel that this fact is important, because both these two companies are engaged in doing what the focus of my legislation is—encouraging companies to manufacture their cars here in our country.

The start and finish of the 3-year phase-in period have been pushed back a year. The revised bill would take effect in 1984, and the schedule would be completed in 1986.

The bill has a revised penalty provision. A violator's imports would be cut back by the same percentage as the violator has fallen short of the content requirement. Under the original H.R. 5133, a company's imports would be reduced by 25 percent regardless of the extent or severity of the violation. The bottom line is that the substitute treats all equally, and the "punishment fits the crime."

In conclusion, Mr. Chairman, each of us realizes that the auto industry plays a key role in the growth and prosperity of every large industrial country. Because of that, no other major auto-producing nation has ever allowed its own auto production to collapse relative to local sales at the rate we have experienced since 1978. In the past 20 years, many governments have intervened at critical stages to prevent the destruction of their national auto markets—among them are Japan, Germany, France, Italy and Britain.

During the consideration of H.R. 5133 by the Energy & Commerce Committee, both proponents of this legislation and those who do not favor it rattled-off statistic after statistic about how many jobs it will provide or not provide, what the impact will be on the price of a car. Both parties recited laundry lists of those organizations that are for and against local content.

While I believe that my bill will result in the employment of upward of 800,000 individuals, and while I don't think that this bill will result in the undesirable side-effects that opponents claim, the bottom line is that the United States cannot continue to cling to open U.S. auto markets while our competitors close theirs to us and make off with our sales and jobs.

The United States cannot continue to play "Uncle Sucker" in light of the practices of Japan, Europe, and others which, while not enforcing auto domestic content laws per se, practice inspection procedures and apply tariffs that exclude our autos and other products from their markets. The opponents of this legislation speculate about possible retaliation. Yet 31 countries have domestic content laws for autos without any retaliation—and all the European countries maintain quotas for Japanese imports without objection. We are the largest auto market in the world, and I just cannot believe that Japan will abandon that market if required to manufacture here.

Mr. Chairman, members of the committee, you know as well as I that there are 300,000 auto workers without a job—and that is a fact.

The time is short. We are talking about the jobs, livelihoods and the economic survival of an estimated 867,000 Americans and their families. we must act, and we must act now.

I thank the committee for this opportunity to come before you, and urge you to report H.R. 5133, as amended by the Energy & Commerce Committee, at the earliest possible date.

MAJOR DIFFERENCES BETWEEN ORIGINAL H.R. 5133 AND OTTINGER SUBSTITUTE

The Ottinger substitute retains essentially the same structure as the original H.R. 5133, but has a number of improvements. Major differences include: (1) a more inclusive definition of "added domestic value"; (2) the schedule of minimum local content requirements is more lenient and is pushed back a year; (3) penalties are based on a sliding scale such that "the punishment fits the crime"; (4) deletion of special treatment for Canada; and (5) replacement of Title II with a charge to the Secretary of Transportation to investigate abuses in the replacement parts market and recommend remedies within a year.

1. A company's "domestic content ratio" is derived by dividing its sales into its domestic costs, defined as "added domestic value." The Ottinger substitute provides a complete accounting of domestic costs, whereas the original bill counted only labor and parts. The omitted costs (depreciation, taxes, interest, utilities, etc.) together add up to 25 percent or more of the total costs for a company. With the original definition, a 90 percent content requirement would not be appropriate. A complete accounting avoids this pitfall. The Ottinger substitute does this in deriving "added domestic value" by taking the company's total U.S. sales, adding its exports and subtracting its imports. Put simply, a 90 percent content requirement means that a company may not have net imports (imports minus exports) greater than 10 percent of its U.S. sales.

2. The Ottinger substitute has a lower and smoother schedule of content ratios. While the categories still begin at 100,000 vehicles, the result will be a fairer application of the law. The substitute schedule divides a company's sales by 10,000, that

is sales of 150,001 entail 15.0001 percent content (down from 50 percent in the original language), sales of 500,001 entail 50.0001 percent content (down from 90 percent) and 90 percent content is reached at 900,000 unit sales and beyond. In practice, this keeps the U.S. "Big Three" at 90 percent, but reduces the percentage for all other companies to ratios more readily within their grasp—i.e. makes it easier for them to comply. A case in point is Volkswagen, which already meets the final requirement for content. The Ottinger substitute does not push Honda much beyond its announced plans to step-up production in America.

Both the start and finish of the 3-year phase-in period have been pushed back a year. The Ottinger substitute starting date is model year 1984 and the total schedule is completed by model year 1986.

3. The substitute has a penalty provision such that a company not meeting the content schedule faces a sliding scale of cutbacks in its imports based on the extent of its violation. A violator's imports would, under the substitute, be cut back by the same percentage as it has fallen short of the content requirement. Under the original language, a company's imports would be reduced by 25 percent regardless of the extent or severity of the violation. Additionally, the Ottinger substitute provides civil penalties to all other violations—such as failure to provide proper and timely information to the Secretary of Transportation. This penalty would be $10,000 a day.

4. The Ottinger substitute treats Canada like any other country. The original bill disallows a company's surpluses in trade with Canada.

5. Title II of the original bill was intended to provide U.S. parts producers with access to import dealerships' repair shops. However, current law deals with the two proposed "unfair trade practices" already. Since the problem remains and the remedy is not evident, the new version directs the Secretary of Transportation to investigate the problem and report back to Congress possible legislative or administrative remedies within a year.

MINOR DIFFERENCES

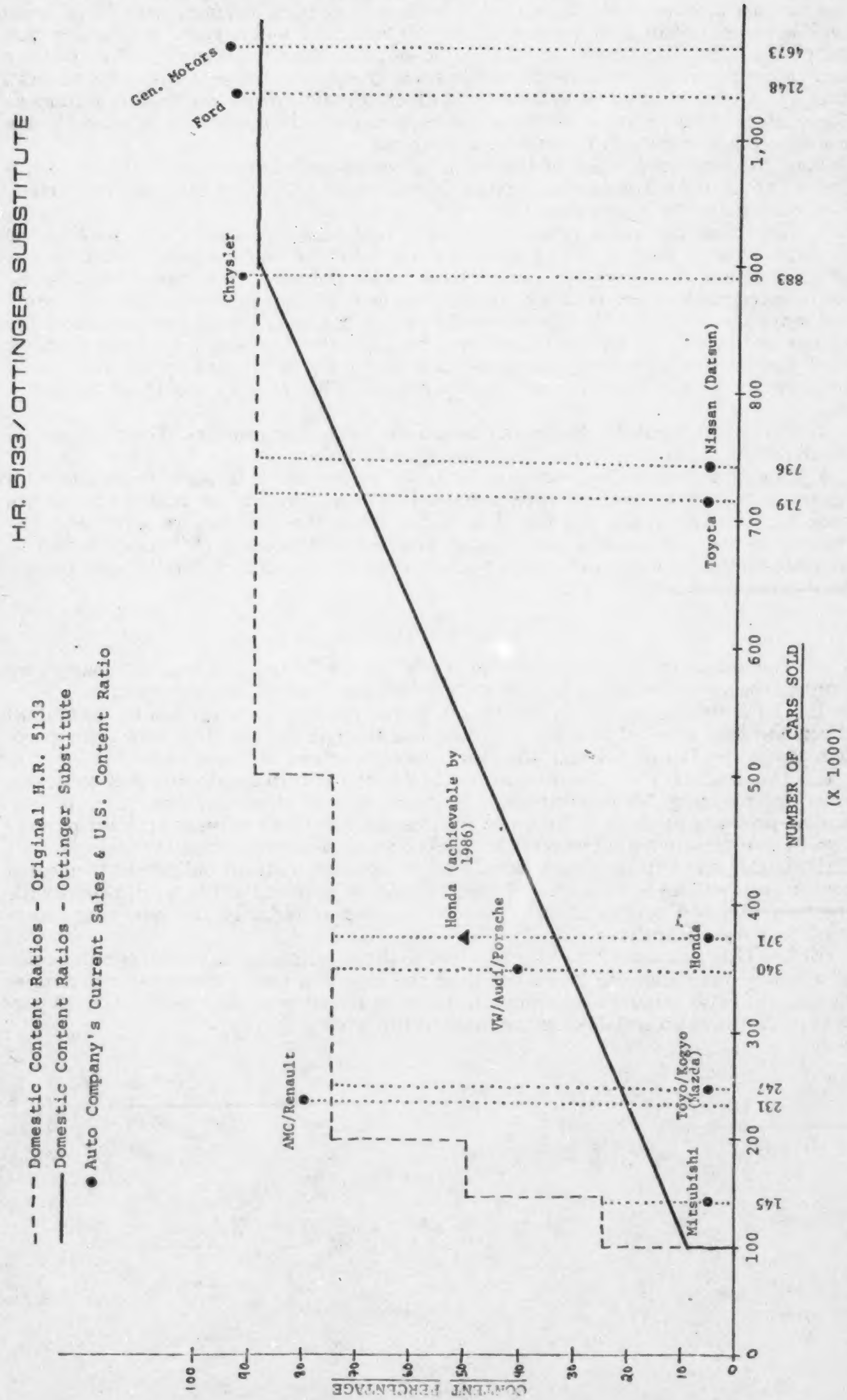
(A) The definition of "automotive products" in the Ottinger substitute clearly confines the scope of the bill to include only vehicles and parts for new vehicles.

(B) The definition in the substitute of "motor vehicle" is simplified to include all three and four-wheeled vehicles weighing less than 10,000 lbs. This avoids the problem of vehicles falling between the cracks as cars, trucks or buses.

(C) The Secretary of Transportation, under the substitute, is directed to devise rules for avoiding "double-counting" in three sets of circumstances: sale of automotive products made here from one vehicle manufacturer to another; joint production by two vehicle manufacturers in the U.S.; and joint production overseas.

(D) Under the Ottinger substitute, only companies with an obligation to meet a content ratio (those with sales over 100,000) will be required to file a full report with the Secretary of Transportation. This has the effect of reducing the reporting paperwork load significantly.

(E) The Ottinger substitute also requires that the minimum domestic content ratio of a vehicle manufacturer be no less than the higher of the following: (1) the domestic content ratio achieved by a manufacturer in model year 1983 reduced by 10 percent or (2) the ratio specified in the table in the bill.


H.R. 5133/OTTINGER SUBSTITUTE

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Chairman GIBBONS. I thank you for coming. I just want to say that we are going to expedite action. I wish your committee had done one-tenth as well. Your committee sat on this bill for a year and a half and did nothing.

You had 3 hours of hearings and heard nothing from the opponents of the legislation. We are at least having fair and complete hearings and will take appropriate action. Unfortunately because of a mistake, this bill was not referred to this committee as it should have. It went to your committee and I respect the mistake. We have had more hours of hearings already than you all had in the whole time you had the bill. We intend to see if we can do something to help what I think is the worst piece of economic legislation in the 20 years I have been in Congress, in the 50 years I can remember very accurately of U.S. history.

I just finished attending a conference this morning of Democratic Members of Congress, in which the lecturer was a very distinguished economist, and in which, when we got to the discussion of the automobile situation, he said this:

You know, the automobile people just priced themselves out of the market. I am paraphrasing now. Their wages are 70 percent higher than the average American industrial wage. If Michigan had been an independent country, it would have devalued its currency and would have worked its way out of this, but, unfortunately, it is a part of the union; it has to live with the rules of the union, and it has lost jobs. It has lost sales.

Yesterday Ambassador Brock pointed out that while the increase in foreign penetration has only been a total of about 400,000 units since 1978. Whereas, the drop in American automobile sales, American-made automobiles, is 4.5 million cars per year.

Your bill will do nothing other than slow down the corrections that the American automobile industry must make before it can recover.

Americans can't afford the cars today. They don't want them in vast numbers. They are not buying them, and when they do get an opportunity, they buy a slightly less expensive import. That is the real problem.

While I respect you, Mr. Ottinger, and you are a colleague and a Member of Congress; however, I must say that I have listened to many of the European Socialists, and your bill would fit right on top of what they say.

They are bankrupting their economies, and I don't intend to bankrupt my economy with their Socialist ideas.

In effect, what has happened here is that we have the automobile industry, including its union, trying to take advantage of all the rest of Americans by saying, "You have got to pay us the price we want for our labor and for our cars. If you don't like it, we are going to use our political clout, and we are going to force you buy them, whether or not you want them." I don't think the American people are going to be receptive to that any more than they were on the restrictive prices that the beef people tried to put on us.

When the beef prices went up, people stopped buying beef, and now there is 20 percent less beef sold than there was. That is the same thing that is going to happen in the auto industry.

In my opinion, the bill would be a disaster for America. I will turn it over to my friend, Mr. Bailey. Mr. Bailey.

Mr. **Bailey**. Mr. Chairman, Mr. Brodhead had preceded me this morning.

Chairman **Gibbons**. I am sorry.

Mr. **Bailey**. I would love to talk first, as you know, and long, if I could, but it wouldn't be fair.

Chairman **Gibbons**. Go right ahead, Mr. Brodhead.

Mr. **Brodhead**. Thank you, Mr. Chairman.

Mr. Ottinger, some of us are very glad you are here. I am delighted that you are here, and I congratulate you on your successful efforts to advance and improve this legislation and commend you for your efforts.

I really don't know where to begin. I don't want to respond to everything that the chairman had to say. The chairman, despite his very strong personal views on this legislation, has given us an adequate opportunity to air the issues involved, and I am grateful for that. I think that there is in certain quarters obviously I think just a simple insensitivity to the fact that about nearly 10 percent, and there is speculation that the next report of the U.S. Department of Labor is going to show that 10 percent of Americans are out of work—we have more people out of work in the United States of America today than at any time during the Great Depression.

Our record does not stand up well in the world, and I think by calling something Socialist or calling something a scheme, maybe we don't take a look at some of the underlying issues involved; that is the destruction of one of our most important, one of our most basic industries, and the problems that that presents not only for the hundreds of thousands of individuals and their families involved in this. In addition, both the military and economic security of our country, are at stake here, and, as you so correctly point out in your statement, Japan itself today protects its auto industry, has a wall of nontariff barriers that effectively prevent American and other foreign competition not only in assembly and in finished products, but in parts and supplies. They built their industry behind a protectionist wall, and were very successful in doing that, so that providing some protection is not necessarily inconsistent with a successful and a competitive industry.

We know that from the Japanese experience not only in autos but in many other areas as well.

Mr. Ottinger, one of the big objections to the legislation and the refrain that we were hearing from the administration witnesses the last couple of days was that the legislation would result in an increase in cost, an increase in price of American cars. I am sure that this is an issue that you had to deal with in the Commerce Committee.

I am sure it is an issue that you and your staff have looked into, and I would like to hear your response to that objection to this legislation.

Mr. **Ottinger**. First, I would like to say that all the capitalist nations of the world are in fact acting to protect their own jobs, not only the automobile industry, but elsewhere. I wish that that were not so.

I think if we could reduce or eliminate all of the restrictions throughout the world and had truly free and open trade that would be the most desirable result, but it is not so in the real world.

In the real world you have got almost 1 million Americans just because of the lack of this legislation who are out of work. In the real world the other countries are protecting their auto industries and we are not, so that I do think that what we are trying to do here is not seek some kind of Socialist scheme, but apply the same kind of remedies that the other countries of the world are applying until such time as there can be an agreement that all the countries will treat each other fairly and equally.

We are not being treated fairly and equally at the present time. We have really been "Uncle Sucker." We have really opened up our markets wide, which indeed made sense in years gone by when we were by far the most powerful economy in the world.

Today Japan and Europe have come up to where they are our equal and they are maintaining the inequities of the past. Those inequities have to be removed, and this legislation will give us that leverage.

With respect to price, as I indicated, this will introduce more competition into the U.S. market. It is not going to result in the exclusion of other companies. We could have done that through quotas.

We took the more enlightened course, and said to the Japanese and the Europeans, sure, you can continue to participate in the benefits of our market, but you just have to produce a substantial percentage of what you sell here in the United States and have it create U.S. jobs.

It seems to me that is an eminently fair position to take, a much less drastic position than Italy takes with its 4 percent limitation on imports, or Germany and England with 10 percent quotas on Japanese imports.

What we are saying is, you can bring as much as you want in here, but you have got to make them here in the United States, and that is not going to result in increased prices.

It is going to result in decreased prices.

Mr. BRODHEAD. I thank you for your excellent statement and for your forthright response to my questions, and I again congratulate you for your leadership on this very vital piece of legislation.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. I thank you very much, Mr. Chairman.

Mr. Ottinger, I wish you had been here yesterday. You might have enjoyed it even more.

I would like to welcome you to the subcommittee and I would like to refer just a little bit to some of the implications in a few of the paragraphs that were in your statement.

This legislative reaction or response is the result of a culmination of a series of inabilities on the part of the United States of America to deal effectively domestically with its own Tax Code, for example, in responding to foreign productivity challenges, failure to write the kind of tax law for many, many years which would have provided the kind of investment environment that would have enabled automobile companies to produce more efficiently.

It is also the result and you are quite correct when you say that it is the result of practices which we have allowed to exist in foreign countries that are absolutely farcical when anybody comes before this subcommittee, as they constantly do, and talks about free enterprise and what it is supposed to mean.

I don't think anyone, and you said it very well, idealizes this legislation as a response to the way things would be in an ideal world, but they are not. We have been prejudiced against. No one on this Earth should be thanked more for this legislation than the Japanese.

People do want to buy American cars. Some of the actions in history that have affected those buying judgments are not our fault. I am sick and tired of hearing our management and our workers blamed because it is just not where the fault lies, so I want to compliment you for introducing the legislation.

We heard some cost/benefit analysis work by the administration yesterday which I don't think really contributes very much, and although this legislation is not ideal, it is going to teach somebody a lesson, and I hope we get it through very soon.

I thank the gentleman very much.

Mr. OTTINGER. I thank you, Mr. Bailey.

I would like to point out that VW that is producing in the United States, Honda that is producing substantial amounts of motor vehicles and is now starting production of automobiles in the United States, to say that their manufacturers in the United States are completely competitive with their manufacturers abroad——

Mr. BAILEY. Mr. Ottinger, you may find something interesting to note also. That there are an awful lot of folks from different parts of the world who would very much have liked to have made some investments here, but they didn't.

The United States, as we have said many times here today, is quite open. We are so darned open that when we twist arms we have a tendency to do it by virtue of codification. We write law in response to problems. There are an awful lot of automobile factories on this Earth today that are placed in some nations other than the United States that are there because some foreign government said thou shalt not sell in our market unless thou manufactures here, and we don't do that.

We have a tendency to look at things in terms of aboveboard, open, legal kinds of ways, so we write legislation like this, but if we had followed the practices of some foreign countries that have attracted some manufacturing investments in the automobile area, quite frankly there would be a great deal more domestic production.

Mr. OTTINGER. Absolutely. I just wanted to get on the record because the chairman did knock the American workers; according to Volkswagen of America, cars built in Pennsylvania are of higher quality than the ones built in Germany.

Mr. BAILEY. Mr. Ottinger, on that point I want you to know that the reason that plant was located in the United States, it is excellent, and I am awfully glad you said that.

By the way, it is located in my district. When Volkswagen came to this country and in particular to western Pennsylvania, the major reason why they made the choice was that they considered it the most productive, the most skilled, the best work-oriented work force that they could find.

That is the reason why they located in the United States of America, and I am proud of western Pennsylvania in particular. That was precisely their top reason.

Mr. OTTINGER. I would also like to put on the record that according to Honda, 90 percent of their Japanese motor vehicle output goes to the dealer directly from the production line. The corresponding portion of their Belgian output is 85 pecent, but for the U.S. output it is 95 percent. I would like to put in the record a statement by executive vice president Kadea Sakura talking about the quality of U.S. motorcycle production in the United States in which he says "The quality of U.S.-made motorcycles is reputed to be equal to or better than the quality of those manufactured in Japan."

Chairman GIBBONS. Mr. Downey?

Mr. DOWNEY. Thank you, Mr. Chairman.

I just want to state for the record that I have known the gentleman from Westchester for so many years, and I know him to be a devout capitalist. I also know him to be a devout Keynesian. I would say to the chairman of the Budget Committee that I don't know what that means any more, but Mr. Ottinger is devout in both instances.

I want you to address for a moment, a number of questions that have been raised here by the administration.

First, they make the contention, which you refute of course, that this will cost American jobs. They further make the point that this will cost the American consumer some $5 billion. You have already said you believe that this would add to competition. How do you address the chairman's argument that the slump in the auto industry is more related to the recession than the penetration of foreign cars in the U.S. market?

Mr. OTTINGER. You have just to take a look at the figures that I have cited of the soaring increase in the percentage of the market as being taken by foreign producers. It is up to 31 percent, so that while part of the reduced sales in the American automobile industry is certainy due to the recession, a large part of it has to be due to an increased penetration by foreign cars in our marketplace.

We are saying that is fine, coming to our marketplace. We are not trying to exclude them we are trying to induce them to produce a greater proportion of their products in the United States.

Chairman GIBBONS. May I make an administrative announcement here?

We have a 15-minute vote on right now on a Ways and Means bill. We will then have a series of 5-minute votes. When the second bell rings, I will recess and we will come back and resume with Mr. Ottinger and then go immediately to Mr. Fraser.

Mr. DOWNEY. The other point that was made by the administration was that this bill would cause prices of other commodities to increase as well. The point was that there would be retaliatory measures that would be taken by other industrial States.

I presume that the other industrial States would be, in this instance Japan, since this is the only country that this bill affects?

Mr. **Ottinger**. I think there is no way that is going to happen, since they all maintain in virtually all products much higher barriers than we do. If they want to challenge this legislation and seek to retaliate against it, then we will certainly, if we have any sense at all, raise the increased barrier, the much higher barriers which they maintain against our products.

Maybe something good would come out of that, but the idea that they are going to successfully retaliate against us I think is just nonsense.

Furthermore, I think you have to look at the existing situation. Each of the European countries maintains quotas and nontariff barriers, and in some cases tariffs as well against imported automobiles. Those would be challenged in any such proceeding.

Thirty-one countries, including several industrialized countries, maintain domestic auto content, and we certainly would challenge against all of those, if Mr. Brock is at all on his toes, in any attempt to attack our legislation.

Mr. **Downey**. I think that a point that Mr. Jenkins made yesterday needs to be emphasized here for the record; and that is, that there has been agreement between Japan to American aerospace companies, McDonnell Douglas and Lockheed, according to Metal Market magazine, a publication I do not read frequently, on June 26, 1978.

The point Mr. Jenkins made, and the article makes, is that the Japanese required 40 percent domestic content of the F-15, an airplane that they mistakenly purchased instead of the F-14 and 45P-3 antisubmarine patrol craft purchased from Lockheed. The Japanese Government required, through its trade agency, an enormous amount of domestic content.

I think, [illegible] pointed out, what we are seeing ever-increasingly in the world [illegible] in the real marketplace, this requirement of domestic content [illegible] you want to sell or if you want to provide for licenses of [illegible]

The point [illegible] don't think that what we are doing here is embarking [illegible] something new, something different. It is indeed what other countries do. We might not like it, but if we are going to be competitive, and if we are going to recognize the realities of the real world, we are going to have to do it.

Mr. **Ottinger**. I agree. I don't like it, but I don't think that we can just be babes in the woods, allow our marketplace and our industrial base to be stolen from us while other countries erect barriers against our products.

Mr. **Downey**. I thank the gentleman.

Chairman **Gibbons**. Mr. Jones?

Mr. **Jones**. Thank you, Mr. Chairman.

Mr. Ottinger, welcome to the committee. I may have a different opinion on how to approach this problem. As you probably know, I am a strong supporter of the reciprocity approach, which I think protects us in the international trade community, as well as here at home, more than this particular approach.

Regardless of that, I wanted to ask you some questions.

First of all, it is true, as you pointed out, that some countries do have quotas, including the United States. We have a voluntary quota system on imports ourselves. Do you know of any other industrial country, any other industrial competitor of ours, that has a domestic content legislation similar to what you are recommending?

Mr. **Ottinger.** Yes. There are 31 countries——

Mr. **Jones.** The industrial competitors, I am talking about, not Brazil and the small ones.

Mr. **Ottinger.** Brazil and Australia are the two industrial countries, relatively developed countries, that have domestic development.

Mr. **Jones.** They are the closest?

Mr. **Ottinger.** Yes.

Chairman **Gibbons.** We are going to have to adjourn now. We have an important series of Ways and Means bills. As soon as the votes are over, Mr. Ottinger, we will come back. Mr. Jones has the floor.

Mr. **Ottinger.** I will be here.

Chairman **Gibbons.** After that, of course, is Mr. Fraser.

[Recess.]

Chairman **Gibbons.** The meeting will please come to order.

We don't have Mr. Ottinger. I had promised him that we would continue with him, but I have just been informed that Mr. Fraser has a plane connection to Boston. Mr. Ottinger can come back at any time he wishes. We will ask him to come back as soon as Mr. Fraser has completed.

So, without objection, we will dispense temporarily with the remainder of Mr. Ottinger's testimony and we will take up Mr. Fraser.

Mr. Fraser, we welcome you here. You are the very fine and effective head of the United Auto Workers of this country, and of Canada, also. We look forward to hearing you on this legislation.

STATEMENT OF DOUGLAS FRASER, PRESIDENT, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, ACCOMPANIED BY DICK WARDEN, LEGISLATIVE DIRECTOR, SHELDON FRIEDMAN, DIRECTOR OF RESEARCH, AND LEE PRICE, ASSOCIATE DIRECTOR OF RESEARCH

Mr. **Fraser.** Thank you, Chairman Gibbons.

On my left is Dick Warden, director of our legislative department. On my right is Sheldon Friedman, director of our research department, and Lee Price, an associate in our research department.

I want to thank you on behalf of our members, you, Mr. Chairman, and the rest of the committee, for giving us this opportunity. I need not tell this committee that the auto industry is in a depression. It is in a desperate state of affairs. We have witnessed nothing like this since the Great Depression of the 1930's.

If you use 1978 as a benchmark, the employment in the auto industry, in the motor vehicle industry, is down by 28 percent. The employment in the motor vehicle industry is now 720,000, and in 1978 it was 1,005,000. You can add to that the ripple effect of the unemployment in the auto industry. Some 670,000 jobs have been lost in industries that supply the auto industry.

In the first 8 months of 1982 we have produced 3,450,000 cars. That is 26 percent below the miserable year of 1981. Some knowledgeable people believe this is going to be the worst year since 1961.

That understates the case because our Nation has grown substantially since 1961, our population has increased by 26 percent, the licensed drivers have increased by 75 percent, the number of cars on the road has increased by 77 percent, and our real GNP has almost doubled. There should be this huge potential out there so that when you compare 1961 to 1982, it really is an understatement of the desperate situation in which we find ourselves.

The best guess for sales of domestic cars this year hovers between 5,600,000 and 5,700,000, and the estimates are lowered almost monthly. We look back to 1978, which is hardly ancient history, the American automobile industry produced and sold 9,400,000 cars. In that year we also sold 4 million trucks, and about 2 million of those 4 million trucks were vans and small trucks that really could have been classified as passanger cars.

So, you could, I think, accurately state that in terms of passenger vehicles, our sales were in the neighborhood of 11,400,000 domestic vehicles in 1978.

During that same period, 1978 to 1981, Japan has increased its production by 32.1 percent in cars and 32.7 percent in light trucks, and its share of the market has increased from 12 percent to 21.8 percent. In July and August, and I suspect it will be the same in September, the Japanese share will be around 27 percent of our market.

As most of you know, the auto industry is crucial to the American industrial base. We consume 21 percent of all of the steel in the country, 50 percent of the malleable iron, 34 percent of the zinc, 12 percent of the primary aluminium, 13 percent of the copper, and 60 percent of the synthetic rubber.

H.R. 5133 is not a quota bill. It is not a tariff bill. We view it as an investment bill, and we say to the Japanese, let's put some capital where your market is. Let's create some jobs where your sales are.

We had a $16 billion deficit with Japan last year, $13 billion of that $16 billion was in automobiles and automobile parts. If you look at the last 5 years, our trade deficit with Japan in automobile and automobile parts alone is $47 billion.

I went to Japan in 1980. I had been here previously and have been there subsequently at the request of Ambassador Mansfield. He asked me to talk to the heads of the auto companies, and I did individually.

I made the argument with them, why don't you behave like a responsible trading partner? Why don't you invest in America like Volkswagen did when it built a plant in Westmoreland, Pa., opened a plant in Charleston, W. Va., and a parts plant in Fort Worth, Tex. Volkswagen also is converting a defense plant in the Detroit suburbs to a new assembly plant. It is almost completed, but because of the condition of the market they put it in mothballs.

Look at Renault and the very substantial investment it has made in American Motors. That has really saved the city of Kenosha, in my view.

H.R. 5133 would maintain competition, unlike a quota or a tariff, maintain competition that is badly needed by the domestic industry. It would provide the discipline that the domestic industry needs not only in terms of price, but in terms of quality.

We estimate that in the absence of legislation like 5133, we will lose 700,000 jobs in the automobile industry, in the supplier industry, by the end of this decade.

We have documented in our complete statement, Mr. Chairman, the restrictive trade practices of other countries in the automobile industry. I won't detail them, but they are in our written submission.

In addition to that, the Japanese do take unfair advantage of our liberal trade policies, the fact that we really do have an open door, and just take automobiles. The Japanese have commodity taxes. When we ship cars to Japan, they cost just about twice as much as they do when they are sold in the United States.

Of course, the reverse is true. When they ship their cars here, they are much cheaper in this country because of the nature of their action. It is a commodity tax, where the taxes on our cars goes frequently to the consumer, because of the different form our taxes take.

I was looking at some figures the other day. In the first 6 months of 1982, the percentage of imports, all imports in the Japanese market was nine-tenths of 1 percent of that market.

Then the obvious discriminatory action that the Japanese Government is able to manipulate is the relationship between the yen and the dollar. It has been said that there is a $1,500 landed cost advantage to the Japanese at the time the cars get off the boats on the east and west coasts. If the yen was valued where many economists and many bankers think it should be, about 180 to $1, you would wipe out two-thirds of that $1,500 advantage.

The Japanese are not reluctant to arrange for content requirement. They have a contract with Lockheed, for the Lockheed Starfighter, and they demand 44 percent Japanese content. They have a contract with McDonnell Douglas for the F-15 fighter plane, 40-percent content. They also have a contract with Boeing for their new plane that has just been certified, the 767. That has a content requirement, also.

Let me raise a question that inevitably comes up when we are talking about the domestic auto industry, and that is the subject of the quality of the American cars.

The argument goes, well, we wouldn't be in difficulty if the American cars were of the same quality as the Japanese cars. I will be the first to admit that we got lax in the auto industry. In 1978 we were working at absolute capacity, and I think our priorities got twisted a bit.

The plant managers were rushing to get the cars out the doors because the dealers could sell every single car that we could produce, except the small ones. We couldn't move the Pintos and we couldn't move the Vegas, but there is another reason for that. They were lousy cars.

But the American people were not interested in small cars in those years. Frankly, we had a monopoly. We had a monopoly in large cars. I am not saying that we sent the cars out the door ignoring quality, but quantity took the place above quality.

I can tell you that that has changed. It changed dramatically. I can state categorically that our cars are of much better quality than they were just 18 months ago.

In addition to that, however, you always get this negative publicity. The fact has been demonstrated time and time again that American cars are safer than Japanese cars. I am talking about cars of like size and like weight. Nobody even talks about that, but certainly that is part of the quality of a car.

Our automobiles—and it is important in some sections of the country—are more rust resistant than the Japanese cars because the gauge of our metal is thicker and we are using galvanized metal more than the Japanese.

We are now accumulating evidence where it is now safe to make the claim that our cars are more durable than the Japanese in what we call the power train over a long period of time.

In addition to that, I would urge committee members to check with Volkswagen of Pennsylvania and ask them about the quality of the cars being produced there. Yes, I ask you to check with Honda in Marysville, Ohio, where we are building motorcycles, and they will tell you that the quality standards there are very, very high.

There is nothing magical about building a quality car. It has to be a car that is well designed, that is well engineered, and then the plant management has to say to the workers, we want our quality up here and accept nothing less than that. That is all it will take, and that is what we are doing.

Let me touch upon another subject that invariably comes up in discussions like that; that is, the question of productivity.

In the auto industry we are proud of the productivity of the autoworkers. That is precisely why we were able to negotiate high wages and rich fringe benefits. There is no secret about that. We would be unable to do it had the autoworkers not been extremely productive.

In the last 25 years we have averaged increases in productivity of 3.5 percent per year. Then you take a year like this year, 1958 or 1974–75, you don't have the productivity because you have extremely low volume.

But a more telling argument, it seems to me, is a study that was released just a couple of months ago by the Japan Productivity Center. That study showed that while there was a wide gap between the productivity of the steelworkers of both countries, in the automobile industry our productivity was only 1 percent below the Japanese.

That study was made in 1980. In 1980 the Japanese auto industry was working at capacity, and you know the situation in our industry. It was low volume, where you lost the economies of scale and all of the inefficiencies that creep in when you are operating at 50 percent or 60 percent of capacity.

So, we don't have any apologies to make for the productivity of the autoworkers. I feel, incidentally, that if we can get the volume up, to get all of those efficiencies—and I think we are on the threshold of a significant breakthrough in the manner in which we assemble cars and build cars in the assembly plant—the productivity of the autoworkers is going to shoot up once more.

Historically, in our union we have never resisted the introduction of new technology and automation. Rather, we encourage it because we know that if we want a larger share of the economic pie, we first must bake a larger pie.

These have been extremely difficult days in the industry. Our union feels that we have done our part. We did something that we have never done in the history of our union; that is, reopened agreements during the course of those agreements, where we made adjustments in our contracts, substantially reducing the cost of building an automobile. Our membership feels that we now need the help of Congress, because we certainly have stepped up to our responsibility.

Nearly every country in the world has an auto policy except our own, and I would hope that this committee would report out favorably H.R. 5133 for the consideration of the entire House of Representatives.

I want to thank you, Mr. Chairman, for this opportunity to share our views with you and your subcommittee.

[The prepared statement follows:]

STATEMENT OF DOUGLAS A. FRASER, PRESIDENT, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURE IMPLEMENT WORKERS OF AMERICA, UAW

SUMMARY

The three and a half year crisis in the U.S. auto industry has cost the jobs of a million workers employed in the industry and supplying it. Despite depression conditions, imports of vehicles and parts, particularly from Japan, have zoomed and thereby aggravated the domestic industry's plight.

The U.S. can no longer afford to have a passive trade and industrial policy toward the industry when all other major auto-producing nations are promoting their industries, pushing their exports, and preventing increases in imports. The Fair Practices in Automotive Products Act, H.R. 5133, is designed to defend our industry in light of the practices prevailing around the world.

Currently, U.S. new car and light truck production represents only three-quarters of the value of automotive sales in our market. Without action by the U.S. government, that ratio can be expected to fall to one-half by 1990. Failure to pass this legislation stabilizing our production-to-market ratio at three-quarters would be very costly to the economy, to hundreds of thousands of workers and their communities, and to government budgets at all levels.

The revised H.R. 5133 would result in more than 700,000 jobs created or preserved in the auto and related industries. With the ripple effect through the economy—based on a "multiplier" identified and quantified in a recent study by the Congressional Budget Office—the total economy-wide impact would be well over a million jobs.

This legislation would lead to substantial investment and purchases here by all foreign auto companies which enjoy a large market here. In addition, foreign sourcing by U.S. companies would be curbed.

H.R. 5133 provides a more than adequate phase-in period for foreign companies to make the necessary investments here to maintain their market shares. As a result, U.S. consumers would continue to have the range of product offerings they desire. Because U.S. companies would continue to face stiff competition, there should be little increase in U.S. car prices.

"Reciprocity" legislation cannot be accepted as a satisfactory alternative to H.R. 5133. Other nations' vigorous auto policies are well-entrenched. We cannot afford to neglect the problems of our rapidly eroding industry while we negotiate with other nations about their auto policies. We must instead adopt an industrial policy of our own.

Because of the urgency of the situation and the limited time left in the legislative calendar, we urge that this Committee complete its actions promptly so that the House can vote on this measure as soon as possible.

STATEMENT

Chairman Gibbons, members of the Subcommittee on Trade, I am Douglas A. Fraser, President of the International Union, UAW. I appreciate this opportunity to testify before your Subcommittee on behalf of the 1.3 million members of the UAW about the crisis in the U.S. auto industry, auto policies around the world, and our recommended response to the challenge they pose.

CRISIS CONDITIONS

The three and one-half year crisis in the U.S. auto industry has taken an awesome toll. Unless the U.S. government adopts an auto policy that deals with the realities of auto trade and investment, the deterioration of our auto industry will continue at an intolerable rate—even if auto sales revive.

At no time since the Great Depression have auto producing communities experienced such high and sustained unemployment. The hopelessness and the personal and social tragedies in those communities exceed all postwar experience. Since 1978, employment in the motor vehicle industry has plummeted 28 percent, from 1,005,000 to 720,000. Another 670,000 jobs have been lost at suppliers to the auto industry, for a total loss of nearly one million jobs.[1]

Sales so far in 1982 have plunged even below depressed 1981 levels leading to further cutbacks in production and employment. For all of 1982, sales are expected to be at their lowest since 1961. A scant 3.45 million cars were produced in 1982's first 8 months, 26 percent below the already dismal level of the year before and 44 percent below the first 8 months of 1978, the industry's last healthy year. To understand the dimensions of the industry's decline, such comparisons have to be put into perspective. The nation has grown enormously since 1961: our population 26 percent; the number of licensed drivers by 75 percent; the number of cars on the road by 77 percent; and our real GNP has nearly doubled.

The crisis in the domestic industry has been severely aggravated by increased imports from Japan. While domestic production plummeted between 1978 and 1981, imports from Japan skyrocketed 37.1 percent for cars and 32.7 percent for light trucks. Japan's share of the shrinking car market swelled from 12.1 percent to 21.8 percent—accounting for more than the entire increase in import share (from 17.9 percent to 27.3 percent). The import share for trucks (all from Japan) bounded upward even faster, from 8.3 percent to 19.8 percent. (See Appendix 1) New records for the share of Japanese cars were set in July, only to be eclipsed in August, when they took 27 percent of our market, boosting the total import share to an all-time high of 32.8 percent. And this jump in import penetration has occurred despite extensive rebates by the domestic companies, and Japan's announcement of voluntary import restraints.

All indicators point to further increases in imports in the coming decade if nothing is done. By 1990, the import share is predicted to be 40 percent by Merrill Lynch Economics,[2] 35.8 percent by Chase Econometrics,[3] and as much as 65 percent under one "scenario" considered by a National Academy of Engineering panel.[4] A General Motors spokesman recently predicted that the import share could reach 40 percent as soon as 1985—the year after GM begins receiving small captive imports from Isuzu, its commonly controlled Japanese affiliate.

The rise in imports has not been confined to finished vehicles. In the last decade, the value of auto parts imported into the U.S. from countries other than Canada has grown at an annual rate of 24 percent. The Department of Commerce estimated in December that 2.5 million engines and 1.7 million transmissions will be imported during each of the next several years. There is considerable evidence that without government action, this will only be the tip of the iceberg. According to a recent survey of automotive industry experts conducted by the accounting firm Arthur Andersen, the imported content of domestically assembled vehicles (now less than 5 percent) could jump to 30 percent by 1985 and to 39 percent by 1990. (Appendix IV is a partial list of major foreign sourcing commitments announced by domestic vehicle companies.)

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[1] The Bureau of Labor Statistics estimates that there are 2.36 supplier jobs for every job at the vehicle companies.

[2] Congressional Budget Office, "The Fair Practices in Automotive Products Act (H.R. 5133): An Economic Assessment," August 1982, p. 14.

[3] Ibid.

[4] "The Competitive Status of the U.S. Auto Industry," July 26, 1982.

IMPORTANCE OF THE AUTO INDUSTRY

This nation cannot have a healthy economy without a healthy auto industry. Auto is pivotal, in terms of employment, technology, and links to other industries. Even in 1981, the industry employed well over 700,000 auto workers and 1,650,000 supplier workers, for a total of 2.35 million jobs. The industry consumes 21 percent of all the steel used in this country, 50 percent of the malleable iron, 34 percent of the zinc, 12 percent of the primary aluminum, 13 percent of the copper and 60 percent of the synthetic rubber.

In every recession in the postwar period, there has been no substantial recovery without a recovery of the auto industry. The failure to recover from the 1980 recession, and the current severe recession—the worst since the 1930s—are both related in no small way to the nation's failure to deal with the crisis in auto.

No other technologically advanced American industry can match the auto industry in terms of size or impact on the rest of the economy. Our auto industry has a solid record of developing new manufacturing technologies and improving productivity. It is widely acknowledged that the Japanese industry has few technologies not already used here, and uses many technologies that were developed here.

The auto industry's leadership on productivity has spillover effects that improve the productivity in other industries. Numerous other industries have adopted production technologies developed by the auto industry. The auto companies have stayed at the forefront in development of manufacturing applications for computers, robots and automated equipment. This nation could not long remain a major industrial economy without a robust and substantial auto industry.

HOW H.R. 5133 WOULD WORK

The rules of H.R. 5133 are designed to assure a healthy and competitive domestic auto industry. The bill also recognizes the critical power of a handful of giant vehicle manufacturers to decide where production will take place to supply the U.S. market.

All companies with annual sales here of over 100,000 vehicles would be required to locate some production here, hire workers here and buy auto parts here. After a one year grace period, the requirements would be phased in over the next three years. The content requirement is based on a vehicle manufacturer's trade balance in automotive products. For example, a 90 percent content requirement permits a company to have net automotive imports (imports minus exports) worth up to 10 percent of its wholesale auto sales here. A company's content requirement is based on a smooth scale that starts at 100,001 vehicles, then rises until 900,000, where it levels off. From model year 1986 onward, the content percentage (up to a maximum of 90 percent) is derived by dividing sales by 10,000. Thus, sales of 355,000 entail a 35.5 percent content requirement.

A "safety net" provision has also been included that prevents a company from reducing its content ratio by more than 10 percent below the 1983 model year. Thus, AMC/Renault which is currently around 80 percent could not fall below 70 percent.

EFFECTS ON EMPLOYMENT AND PRICES

H.R. 5133 would create or preserve over one million jobs; it would not trigger substantial car price increases; it would promote productivity by permitting corporations the flexibility to rationalize production internationally

The UAW believes that by the end of the decade, enactment of H.R. 5133 would create or preserve over one million U.S. jobs, including 200,000 auto jobs, and 500,000 supplier jobs that we would not otherwise have, based on reasonable assumptions about trends in imported vehicles and parts.

U.S. automotive production currently amounts to about three-quarters of the value of new cars and trucks sold here. Imported vehicles and parts in excess of U.S. automotive exports account for the remaining quarter of our market. By requiring U.S. production and purchases by all companies with large sales here, this bill would stabilize the future ratio of U.S. production to sales at roughly three-quarters. In the absence of the local content law, by the end of the decade U.S. automotive production as a share of the market can be expected to fall to about one-half of U.S. auto sales. A fall in U.S. production from three-quarters to one-half of the auto market would eliminate the jobs of more than 200,000 auto workers—and 5.5 times that many outside the auto industry.[5]

To stabilize U.S. auto production relative to the market, the bill addresses imports of both vehicles and parts. Instead of rising to their predicted 40 percent share of the market, many vehicles which would otherwise have been imported will instead be built here or at least assembled here with imported parts. The overall domestic value-added of foreign companies would rise to roughly 50 percent of the value of their sales here, instead of remaining at about 5 percent. In addition, net foreign sourcing by the largest U.S. companies would be capped at about 10 percent of their sales here, and prevented from rising to an otherwise probable 20 percent by 1990.

H.R. 5133 would have a very limited effect, if any at all, on competition and consumer choice in the U.S. auto market. Just as dire predictions of the price effect of the Japanese export restraints negotiated in May 1980 have been given the lie by 2.9 percent annual auto price inflation over the past year—less than half the overall rate of inflation and the lowest auto price increase in any recent year—so too are forecasts of H.R. 5133's price impacts grossly overstated. For example, in its analysis, the CBO predicted that prices would rise 6 percent; the Congressional Research Service predicted 4.3 percent. However, both assumed that the bill would function as a quota, substantially curtailing foreign companies' competition with U.S. companies. In fact, the CBO predicted that foreign companies would have 3.75 million units in U.S. sales by 1990 in the absence of content, but only 1.35 million with content. Since, however, under the bill as amended foreign companies would surely respond by investing in an attempt to maintain or increase their current shares of the market, any forecast of higher prices based on greatly reduced vehicle availability is invalid.

A domestic content law also retains competition among the world's auto companies to provide the American consumer with a wide variety of innovative products built with the most efficient technologies available. The U.S. producers would continue to be pressured by the discipline of the design and engineering innovations of foreign-based manufacturers. As such, a bill such as H.R. 5133 is clearly superior to measures limiting car imports.

H.R. 5133 leaves a company ample flexibility either to integrate it U.S. operations into a global production network or to produce simply for the local market. It must generate production here, but can choose which parts or assembly it wants to have done here and which it wants to have done elsewhere to supply this market.

In sum, this is a very effective jobs bill, not only for the auto industry but for the economy as a whole. The additional million jobs—many of them in communities already hard pressed with high unemployment—are obtained at little cost in terms of inflation, consumer choice, and efficient management. The cost of inaction is far greater.

A metalworking industrial base at risk;

A $25 billion annual loss to the Treasury due to taxes not paid and transfers necessitated; and

A massive regional fiscal crisis.

SUPPORT FOR "SELL HERE, BUILD HERE"

There is widespread support for the proposition that companies enjoying large volume sales here should be investing here. Business Week and Automotive News have supported the concept of local content legislation for the U.S. auto industry. (See Appendices VI and VII.) Ichiro Shioji, president of the Japanese Auto Workers, has advocated for several years that Japanese auto companies make significant investments in countries where they have large markets, notably the U.S.

Two large foreign companies have already made substantial commitments here relative to their sales. VW began U.S. production in 1978. Now, in addition to its assembly plant in Pennsylvania, it has a stamping plant in West Virginia and a parts plant in Texas. It hopes to open a second assembly plant, in Michigan, in the near future. VW has reported that its domestic content for the Rabbits built here is 70 percent. Renault has made a substantial commitment, providing capital and working with AMC to retool its Kenosha plant to build the Alliance.

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[5] According to the economic model developed by the CBO, for every additional job in the auto industry by 1990 there will be a positive ripple effect adding 5.5 more jobs in the rest of the economy—assuming no retaliation, which we consider appropriate for reasons discussed later and in Appendix VIII. The CBO, however, ignores the effect of the bill in curbing the rise of the import share and of foreign sourcing. (See appendix VIII)

These VW and Renault actions are merely the latest chapter in the thoroughly multinational eight decade history of the auto industry around the world. GM, Ford. Chrysler, VW, Renault, and Fiat have for decades built in regions where they enjoy significant sales.

In contrast, Japanese auto companies had exports of $13 billion to the U.S. last year. With that $13 billion allocated according to their relative sales here, Toyota and Nissan/Fuji (maker of Datsuns and Subarus) accounted for $4 billion each and Honda for $2 billion.

Toyota has made no public commitments for significant U.S. production, although the Toyota Group (including Hino) does assemble vehicles in other countries, including Australia, Brazil, Canada, and Ireland.[6] Under clear political pressure to do some production here, Toyota has been negotiating with GM to assemble vehicles jointly in the U.S. in 1984 or 1985. The extent to which that arrangement actually increases U.S. production will depend on whether Toyota knows that to be the goal of the U.S. government.[7]

Nissan and Fuji Heavy Industries (which Japanese industry analysts consider to be commonly controlled vehicle manufacturers) have very modest plans to begin truck assembly in Tennessee this year. Relative to the size of its sales in the respective markets, Nissan/Fuji has invested far more heavily in recent years in Australia, Mexico, Italy, and Spain [8] and has been negotiating for a $500 million assembly in the U.K.

Relative to its sales here, Honda is making a better commitment to output and employment here. Later this year, it will start building cars in Ohio and expects soon to achieve 50 percent local content for 150,000 cars a year. Both the content percentage and number of cars assembled at that plant can—and should—be increased substantially.

AUTO POLICIES IN OTHER COUNTRIES

Because foreign governments have taken decisive actions to promote and protect their respective auto industries, world trade in automotive products today bears no resemblance to the textbook world of "free trade." In fact, the measures involved in H.R. 5133 are quite modest in comparison to those imposed by the governments of all other major auto-producing nations, including Japan, the members of the European Community, Australia, and the more advanced developing countries.

With prohibitive tariffs, Japan kept out auto imports until the early 1970s. Since then, while phasing out their tariffs, they have relied on non-tariff barriers. They have stiff product standards that differ substantially from those of other countries. In addition, they extensively inspect each imported car, rather than inspecting a sample of cars and then accepting the manufacturer's self-certification (which is the practice in the U.S.) There are no domestic/import dealers as there are here, so import dealers in Japan have very low volume. As a result of these and other non-tariff barriers, no foreign auto maker has been able to break out of the vicious cycle of low volumes and high overhead. The consumer pays twice as much for a U.S. car in Japan as for the same car here. At the same time, the stiff Japanese commodity tax—rebated on exports—holds down the U.S. price of Japanese cars, while domestic cars bear a full U.S. tax load. The effectiveness of its barriers is shown by the 0.9 percent share held by imported vehicles in the Japanese market in the first half of 1982.[9]

Thriving and expanding beyond the potential of its own protected home market, the Japanese industry has now become the world's largest exporter. All other major auto-producing nations have reacted to this by restricting imports from Japan. In every case this was done well before their domestic industry suffered injury to the extent that the U.S. industry has. France froze the Japanese share at 3 percent in 1978, and last year cut that back to 2½ percent. Italy with car sales of about 900,000 does not permit more than 2,200 autos a year to enter from Japan.[10] Germany has forced Japan to accept no more than about a 10 percent share of its market. The U.K. has not only curbed Japanese imports but forced Japanese cars to be produced there. A "gentlemen's agreement" between the industries of the U.K. and Japan has limited Japanese exports to no more than 10–11 percent of the British market. When Japanese trucks began surging into the U.K. last year, an agreement was reached to stop all shipments for five months. Under those conditions, the British government-owned BL, Ltd. arranged to assemble Hondas under license.[11]

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[6] Japan Motor Industry Federation, "Guide to the Motor Industry of Japan 1982."

[7] Under similar political heat in 1980, Toyota publicized comparable meetings about a joint venture with Ford and three investigations about the viability of independent investment here. When the heat died down, so did the talks with Ford and the results of the three studies were not make public. Presumably, if these studies had reached conclusions that satisfied Toyota, they would have been publicized; we suspect that Toyota may have suppressed findings that U.S. investment would be viable.

[8] Ibid.

[9] Japan Automotive News, August 1982.

[10] That, no doubt, was helpful leverage in getting Nissan to enter a joint venture with Alfa Romeo to produce cars in Italy.

In contrast to these prompt and forceful actions, the U.S. took no action as the Japanese share of our car market skyrocketed from 12.1 percent in 1978 to 21.2 percent in 1980; even the restraints achieved last year did not prevent the import share from rising still further to 21.8 percent in 1981 and 23.0 percent so far in 1982.

Japan is not alone in promoting automotive exports while virtually prohibiting imports. Just this spring, the Brazilian government announced that it had negotiated with foreign auto and machine tool companies for export commitments worth $16.7 billion for the next three to seven years. Mexico, South Korea, and Taiwan are also launching multi-billion dollar programs to boost production far in excess of the requirements of their limited and highly protected internal markets.

Internal U.S. auto company documents[12] give direct evidence that foreign subsidies and export requirements have cost many of our members their jobs. Often, based on strictly economic considerations, the company would have invested or sourced in the U.S. except for the subsidy or export requirement.

Continued passivity in trade and industrial policy will inevitably lead to further erosion of U.S. auto production. We provide the most open and inviting auto market in a world which is actively promoting exports and/or shutting off rising imports.

GATT, RETALIATION, AND U.S. EXPORTS

Some critics of H.R. 5133 argue that retaliation against U.S. exports would nullify the gains to the auto industry. The assumption that massive retaliation from Japan is likely cannot be supported by a careful analysis of auto policies around the world, the political context of the GATT, and Japan's trade patterns.

Japan has never brought a GATT complaint, much less retaliated against the dozens of countries which restrict Japanese auto exports much more stringently than H.R. 5133. Indeed, to achieve or maintain their market presence, Japanese auto companies have invested in many of those countries. Once the Japanese companies have begun to comply in earnest, they will discourage the Japanese government from pursuing a GATT complaint.

The GATT procedures require that Japan first meet with the U.S. to try to iron out difficulties before a formal complaint is filed. If Japan were to file a formal complaint, the U.S. could file countercharges against the auto policies of Japan and many other GATT members in Europe, Australia, Latin America, and Indonesia.

An analogous situation occurred after the U.S. enacted Domestic International Sales Corporation (DISC) legislation giving special tax breaks to exporters in 1971. At that time, several European countries lodged complaints with the GATT. The U.S. countercharged against policies of those countries and argued that, if the DISC did violate the GATT, those countries were also violating the GATT with comparable measures. In effect, the U.S. defended the DISC as necessary for U.S. exporters to compete fairly on the world market because other countries were subsidizing their exports. Several years later, a GATT panel ruled that both the DISC and the foreign rules did violate the GATT. Since that time, the other countries have not changed their practices, nor has the U.S. modified the DISC to conform to the GATT.

Likewise, the Fair Practices in Automotive Products Act is a modest defensive measure; the quotas, content rules, and export requirements of other countries are generally far more severe than this legislation.

As a practical matter, Japan has a very limited capacity to take action against the U.S. even if it were to go to the GATT and prevail. If Japan could win a GATT ruling against U.S. auto content legislation, the U.S. could win rulings against the auto policies of most other auto-producing countries. Even if that point should be reached, it would not be in Japan's interest to take action against U.S. exports.

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[11] Both Italy and France have decided that those Hondas will be counted in their quotas on Japanese cars because they lack sufficient European content. The U.K.'s ability to complain about these de facto local content requirements is limited because it has been negotiating with Nissan to build cars there under the condition that they have 80 percent local content.

[12] Brought to light in March 7, 1980 hearings before the Senate Labor and Human Resources Committee.

Japan buys from the U.S. only what it cannot make for itself: raw materials and products using technology it does not yet have. For many of these products, the U.S. is Japan's predominant supplier; and for those imports for which Japan does have alternative sources, those source countries have auto policies far more restrictive to Japanese auto imports than the proposed U.S. legislation: Australia, Argentina, Brazil, Indonesia for foodstuffs and raw materials; European countries for manufactured goods. Japan could retaliate against modest U.S. auto content legislation only by buying less from us and more from countries with auto policies which limit their exports even more severely than would H.R. 5133.

RECURRING PROBLEMS WITH JAPAN

The U.S. will have recurring trade crises with Japan for as long as we continue to take a passive approach to trade and industrial policy and Japan takes an activist approach. The impact of our two nations' contrasting approaches to trade and industrial policy has been overwhelming for certain U.S. industries. Mr. George Ball pointed this out several years ago:

One of the problems of Japanese trade expansion is that it's been incisively targeted. You (Japan) practically destroy certain industries in the United States—transistor radios, then television, and the like. There is a feeling in the United States that the way your trade is targeted corresponds to a whole different set of values. It responds to governmental decisions in Japan, not simply decisions of industry.

This is what is meant by a structural difference between our two systems. MITI decides to make a great effort with computers, so it reorganizes the Japanese computer industry in order to export. Some other industry may be targeted tomorrow. This is what gives apprehension to American industry: maybe they will be singled out next—not merely by the efforts of one Japanese company, but by a combined, national, centrally orchestrated and directed effort, with assistance from the state in the form of reorganization of the industry, assistance with research, and public financial help.[13]

The U.S. auto industry has certainly been successfully targeted for such export effort, and today the auto situation represents by far the largest single problem in the U.S.-Japan trading relationship. Last year, when the U.S. had an overall trade deficit with Japan of $16 billion, the deficit in auto trade amounted to $13 billion.

Over the last several years of friction over auto trade, Japan has made noise about redressing imbalances, but done little. An editor of the Japan Economic Journal has aptly described the Japanese strategy in trade negotiations with the U.S.: "Making easy promises and postponing real action almost indefinitely." [14]

As our auto deficits with Japan have mushroomed ($47 billion over the last five years), the Japanese have sponsored dozens of meaningless study teams and issued countless press releases, each promising a more balanced relationship in automotive trade and investment. In 1980, the Japanese vehicle companies conducted a much ballyhooed "parts buying mission" to reduce tensions caused by our then $1.3 billion auto parts deficit with Japan. At its conclusion, the spokesperson for the mission assured the American public that the Japanese auto companies would probably buy $300 million worth of U.S. auto parts in 1981. However, even this meager commitment was subsequently revoked in the wake of the voluntary import restraint. U.S. Commerce Department data indicate that our 1981 exports of auto parts to Japan amounted to $119 million, little more than the $105 million for 1980 once inflation is taken into account. Between 1980 anmd 1981, however, our auto parts imports from Japan soared 30 percent ot $1,790 million, causing the parts deficit to widen by another $401 million.

Meanwhile—using content as a tool—Japan has moved to establish itself as an exporter of aerospace equipment. The Japanese Ministry of International Trade and Industry (MITI) has been actively promoting local production and technology transfer for the Japanese aerospace industry. To that end, it has required local production as a condition of its purchases of aerospace equipment from the U.S. The activities of three Japanese companies (Fuji, Kawasaki, and Mitsubishi) have been coordinated to develop the industry's international competitiveness in coming years.

When the Japanese government made multi-billion dollar purchases of military aircraft from McDonnel Douglas and Lockheed, it required an average of 40 percent or more of their total value to be produced in Japan. Japanese content would start low and, over the several years of deliveries, rise until virtually all of the final aircraft would be made in Japan.

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[13] "Japan, The United States and The World," a conversation with George Ball, et al., Japan Information Center, New York 1979.

[14] Japan Economic Journal, August 24, 1982, page 20.

The situation is more complex but equally telling in the case of the arrangements made for the three Japanese companies to build 15 percent of the value of all the new-generation Boeing 767s to be sold worldwide. At the time (fall 1978), the competitiveness of Japanese exports was at an historic low because the yen was being traded at 180 to the dollar. The Japanese government has leverage over Boeing since Japan Air Lines is government-owned and is a large potential customer of Boeing plans. The Japanese government formed the aerospace arms of the three companies into the Civil Transport Development Corporation (CTDC), negotiated with Boeing on the CTDC's participation in the 767 project, and provided the CTDC with a $100 million subsidy. Although neither Boeing nor the Japanese government has stated publicly that local production is a quid pro quo for Boeing sales to Japan, it is widely acknowledged in the industry that local production has become a widespread condition of foreign sales.

JAPANESE INVESTMENT HERE AND "RECIPROCITY"

In the last year, several versions of "reciprocity" legislation has been proposed to press the U.S. government to take a tougher stand in negotiations over the trade policies of foreign governments, especially Japan's. The various "reciprocity" bills call on our trade negotiators (1) to investigate unfair trade practices of foreign governments; (2) to demand that those practices be changed; and (3) to back up our demands with the threat of closing the U.S. market to some exports by the offending country if it does not stop those practices.

Although we support meaningful Congressional efforts to strengthen the hand of the U.S. Trade Representative in international negotiations on the full range of economic dealings, "reciprocity" legislation would not be an effective substitute for H.R. 5133.

The type of reciprocity legislation acceptable to the Administration would merely clarify that it has authority under Section 301 to investigate, negotiate, and retaliate over unfair trade practices in services (e.g., banking, accounting, engineering), and not just goods. The Administration would also have to make an annual report to Congress on the foreign practices that it considered unfair. Experts on this legislation generally agree that it does nothing to change the current authority of the President to handle trade problems for U.S. products. In other words, this reciprocity legislation affects neither the auto industry's problems nor those of any other industry except for services.

Even if reciprocity legislation *had* teeth, the proposed legislation would not be the answer to our international trade and investment problems. To require the U.S. government to retaliate whenever it cannot get foreign governments to stop their "unfair" practices would present a recurring dilemma: either we raise a lot of U.S. barriers or, to avoid that, the President feels compelled to declare that the foreign government has really done nothing wrong (as in the semi-annual certification of human rights progress in El Salvador).

Finally, Section 301 of current U.S. trade law already gives the President authority to investigate, negotiate over, and retaliate against unfair foreign trade practice affecting U.S. products. Because that authority has almost never been used, some want to require the Administration to take action, or otherwise make non-action more difficult. However, to be realistic, we must recognize that foreign governments will rarely change practices that Americans might consider "unfair" to our exports or imports, regardless of the threats coming from the U.S. Other countries do not consider it "unfair" for their governments to play an active role in their economies to raise output and jobs.

On the other hand, H.R. 5133 would move the U.S. toward reciprocity in its overall economic relationship with Japan, in terms of trade, capital and technology. Our current lack of reciprocity with Japan does not stop with problems of getting access to the Japanese market. Japan has benefited immensely from American technology and virtually unlimited access to U.S. market. Today Japan is brimming with technology and capital of its own, but has shared very little of them with us. Japan will make effective progress toward reciprocity with the U.S. when H.R. 5133 is implemented. That would further integrate our two economies while providing badly needed jobs in the production of autos and parts, giving the industry an infusion of investment, transferring Japanese-developed technology, and alleviating the massive auto trade deficit.

In addition to obtaining new investment here by Japanese auto companies, H.R. 5133 would restrict rapidly increasing foreign sourcing by U.S. companies, i.e. their importing of cars and parts. Reciprocity legislation for negotiating with foreign governments does nothing about this.

In summary, H.R. 5133 deals with the twin trade problems of the auto indusry—rising imports of vehicles and foreign sourcing by U.S. companies—while reciprocity legislation does not address either problem.

THE AUTO INDUSTRY CAN BOUNCE BACK

We face a real threat of continued displacement of our auto industry by foreign production. But we disagree with some economists who would have us believe that any industry with import problems should be abandoned. With appropriate backing by government, the industry can bounce back and—as it has historically—contribute significantly to the strength of the rest of the economy.

The UAW knows that major responsibility falls on the industry itself, and on labor, to take resolute action; we do not shrink from our role and responsibility in that regard. We have undertaken the difficult step of re-negotiating our agreements with the major auto companies prior to the normal expiration of those agreements. We have never stood in the way of new technology, as evidenced by auto's substantial 3.2 percent average annual increase in productivity over the last 25 years—well in excess of the all-manufacturing average. In spite of flagging production, the industry's productivity staged a comeback in 1981, when it chalked up a remarkable 4.7 percent increase. Indeed the U.S. industry is by no means as seriously uncompetitive as certain analysts contend: a study just released by the Japan Productivity Center shows Japan pulling a mere one percent ahead of the U.S. in 1980 in auto industry productivity—when our industry was operating at seriously depressed rates and the Japanese operated at optimum capacity.[15]

Product quality is justifiably of utmost concern to consumers. American-made vehicles have been and continue to be the leaders in those aspects of quality leading to greater durability and safety. Indeed, not only are U.S. made cars safer than Japanese imports, but according to NHTSA crash test data U.S. small cars are safer than Japanese small cars. Recently, the industry has made great strides in improving what is known as the "fits and finishes" aspect of quality, and we sense a serious commitment by corporate management to continue progress in this area.

Where direct comparisons can be made—those cases in which a foreign-based producer has established manufacturing facilities in the U.S. which make products similar to those produced in the home country—American workers have contributed to superior quality. According to Volkswagen of America, cars built in Pennsylvania are of higher quality than those built in Germany. According to Honda, 90 percent of their Japanese motorcycle output goes to the dealer directly from the production line; the corresponding portion of their Belgian output is 85 percent and for the U.S. it is 95 percent.

Finally, any cost advantage enjoyed by the Japanese—even the alleged $1,500 landed cost differential so often cited—would melt to $500 with the yen more appropriately valued.[16] Relative to the dollar, the yen is depressed as a result of both the tight monetary policy of our Federal Reserve and the insulated Japanese capital market imposed by their government. A reversal of the Federal Reserve's policy would not only greatly increase car sales overall by reviving the economy, but would give an extra boost to sales of domestic vehicles.

NEED FOR GOVERNMENT ACTION

The industry and the UAW cannot solve the U.S. auto crisis alone. The government also has a role, starting with implementation of H.R. 5133 and relaxation of monetary policy. Unless content legislation is enacted, many of the steps the U.S.-based auto multinationals are taking to improve their competitive position will cause further widespread unemployment and continued erosion of the nation's industrial base: regional economic stability and employment are not inherently corporate goals.

Nor will the current policies of the Administration meet those goals. Quite the contrary, those policies have plunged us into a new recession with record jobless rates. Even if the economy stabilizes, there is no guarantee that new investment will finance domestic auto revitalization in the absence of content legislation.

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[15] New York Times, July 19, 1982.

[16] Many observers, including U.S. Trade Ambassador Brock and respected economists in both the U.S. and Japan, contend that the yen should have a value of 15 to 20 percent above its current level relative to the dollar. Moreover, even apart from this, a recent paper by Professors Gomez-Ibanez and Harrison of the Harvard Business School raised serious doubts that the cost gap is as large as $1,500. They concluded that the true figure could easily be half that amount.

CONCLUSION

Because our auto policy is out of step with the rest of the world, our industry threatens to continue its disastrous tailspin for much of the remainder of the decade. Other major auto-producing nations are actively promoting exports, preventing increases in imports, and financially assisting their home-based producers. To continue our passive trade and industrial non-policy in such a global environment means that, even when auto sales recover, U.S. production will fall far behind the pace.

H.R. 5133 would prevent further catastrophic erosion of auto production and employment in the world's largest auto market. It would curb the alarming rise in foreign sourcing by U.S. companies, while inducing foreign-based companies to invest here. Because of the magnitude of the industry and the ripple effect on suppliers and spending, the bill would create or preserve over a million additional jobs in the U.S. economy by 1990.

Thank you for this opportunity to speak in favor of the Fair Practices in Automotive Products Act, which is the UAW's highest legislative priority. I hope the members of this Subcommittee will support H.R. 5133, and expedite your action on the bill so that it can come to a full House vote as soon as possible. I am prepared to respond to any questions you may have.

APPENDIX I.—NEW VEHICLE SALES IN THE UNITED STATES

	1981		1980		1978		Change in sales	
	Sales	Shares (percent)	Sales	Share (percent)	Sales	Share (percent)	1981/80 (percent)	1981/78 (percent)
Cars								
GM	3,796,696	44.5	4,116,482	45.9	5,341,700	47.9	−7.8	−28.9
Ford	1,380,600	16.2	1,475,231	16.4	2,536,738	22.7	−6.4	−45.6
Chrysler	729,873	8.6	660,017	7.4	1,087,987	9.7	+10.9	−32.9
AMC	136,682	1.6	149,438	1.7	170,739	1.5	−8.6	−19.9
VWA	162,005	1.9	177,084	2.0	22,651	0.3	−8.3	....
Domestic	6,206,296	72.7	6,578,252	73.3	9,159,815	82.1	−5.7	−32.2
Toyota	576,491	6.8	582,204	6.5	441,800	4.0	−1.0	+30.5
Datsun	464,805	5.4	516,884	5.8	338,096	3.0	−10.1	+37.5
Honda	370,705	4.3	375,388	4.2	274,876	2.5	−1.3	+34.9
Mazda	166,105	2.0	161,440	1.8	75,326	0.7	+2.9	+120.5
Subaru	152,062	1.8	142,969	1.6	103,274	0.9	+6.4	+47.2
Mitsubishi	110,940	1.3	129,350	1.4	103,292	0.9	−14.2	+7.5
Isuzu	17,513	0.2	....	....	19,222	0.2	....	−8.8
Japanese	1,858,622	21.8	1,908,235	21.2	1,355,886	12.1	−2.6	+37.1
European	488,484	5.3	490,048	5.5	644,029	5.8	−4.4	−27.3
Imported	2,327,106	27.3	2,398,283	26.7	1,999,915	17.9	−3.0	+16.4
Total cars	8,533,402	100.0	8,976,535	100.0	11,159,730	100.0	−4.9	−23.5
Trucks								
Domestic	1,809,855	80.2	2,002,532	80.5	3,872,367	91.7	−9.6	−53.3
Imported	447,568	19.8	484,614	19.5	337,169	8.3	−7.6	+32.7
Total Trucks	2,257,423	100.0	2,487,146	100.0	4,209,536	100.0	−9.2	−46.3
Vehicles								
Domestic	8,016,151	74.3	8,580,784	74.9	13,032,182	84.8	−6.6	−38.5
Import	2,774,674	25.7	2,882,897	25.1	2,337,084	15.2	−3.7	+18.7
Total	10,790,825	100.0	11,463,681	100.0	15,369,266	100.0	−5.9	−29.8

APPENDIX II.—THE STATUS OF THE U.S. AUTO INDUSTRY

August 1982 was the 42nd month of the U.S. auto slump. So far in 1982, domestic sales are running 8 percent behind 1981, and 42 percent behind 1978, the last healthy year.

During the same 1978-82 period, European new car sales in the United States have also declined, though by a slightly smaller amount—38 percent.

But U.S. sales of new Japanese-made cars and small trucks are running 25 percent ahead of 1978, despite voluntary export restraints on cars and the August 1980 reclassification of light trucks-minus-beds as trucks.

NEW CAR AND TRUCK SALES IN THE UNITED STATES

[January 1 to August 31 of years shown]

	1982		1981		1978		Change in sales	
	Sales	Share (percent)	Sales	Share (percent)	Sales	Share (percent)	1982/81 (percent)	1982/78 (percent)
European cars	286,360	5.4	343,654	5.6	459,267	5.9	−16.9	−37.7
Japanese cars(+)	1,214,182	23.0	1,339,119	22.0	964,130	12.4	−9.3	+25.9
Imported Cars(=)	1,500,542	28.4	1,682,773	27.6	1,423,397	18.3	−10.9	+5.4
Domestic cars (+)	3,774,136	71.6	4,406,921	72.4	6,346,170	81.7	−14.4	−40.5
Total cars (=)	5,274,678	100.0	6,089,694	100.0	7,769,567	100.0	−13.4	−32.0
Japanese trucks	259,726	15.0	313,410	19.6	212,130	7.5	−17.1	+22.4
Domestic trucks (+)	1,466,387	85.0	1,284,561	80.4	2,618,981	92.5	+14.2	−44.0
Total trucks (=)	1,726,113	100.0	1,597,971	100.0	2,831,111	100.0	+8.0	−39.0
European cars	286,360	4.1	343,654	4.5	459,267	4.3	−16.7	−37.7
Japanese cars and trucks (+)	1,473,908	21.1	1,652,529	21.5	1,176,260	11.1	−10.8	+25.3
Imported vehicles (=)	1,760,268	25.1	1,996,183	26.0	1,635,527	15.4	−11.8	+7.6
Domestic Vehicles (+)	5,240,523	74.9	5,691,482	74.0	8,965,161	84.6	−7.9	−41.5
Total cars and trucks (=)	7,000,791	100.0	7,687,665	100.0	10,600,688	100.0	−8.9	−34.0

As a result of these anemic sales and output levels, layoffs remain high. As of early September—not counting those not working because of model changeover shutdowns—about 220,000 U.S. hourly auto workers were on indefinite layoff. The number on the active rolls stands at approximately 490,000, down 35.5 percent from 760,000 in 1978.

Appendix III.—Major (over 500 jobs)— big 3 automotive plant closings announced 1980-82

	Jobs[1]
Chrysler:	
Hamtramck, Mich.	5,600
Lynch Road, Detroit	5,000
Missouri Truck, St. Louis, Mo	4,100
Warren, Michigan, Recreational Vehicles	2,000
Mack Avenue Stamping, Detroit	4,100
Eight Mile-Outer Drive Stamping, Detroit	2,400
Windsor Engine, Ontario	2,400
Detroit Universal, Detroit	1,100
Lyons Trim, Mich	700
Scio Electronics, Mich	600
Cape Canaveral Electronics, Fl	500
Huber Avenue, Detroit	2,400
Fostoria Iron, Ohio	650
Eldon Axle, Detroit	950
Vernor Tool and Die, Detroit	680
Ford:	
Mahwah, N.J	4,800
Los Angeles, Calif	2,300

Flat Rock, Mich	5,000
Windsor, Ontario	1,600
Aluminum Casting, Sheffield, Ala	1,100
GM:	
Fort Street Trim, Detroit	2,980
Coit Road Stamping, Cleveland	2,770
Hardware Parts Plant, Trenton, N.J.	3,615
Automotive Trim, Euclid, Ohio	1,115
Freemont, Calif	2,550
Southgate, Calif	2,550
Framingham, Mass.	2,500
Lakewood, Ga.	4,600
Corner Avenue Stamping, Detroit	1,150

[1] At time closing announced. Past employment was often much higher, e.g., Hamtramck—28,000 and Eldon Axle—2,400.

In addition, several hundred auto supplier plants have been closed over the last several years and 2,927 dealerships have closed their doors.

APPENDIX IV—FOREIGN SOURCING

[Partial list of known 1977–81 commitments by major U.S. automobile manufacturers to purchase foreign-made major components for use in domestic nameplate vehicles]

Manufacturer and component	Intended for	Source	Approximate number of components	Delivery beginning
GM				
2.8 liter 6 cyl	Cars	GM de Mexico	400,000 per year	1982
2.0 liter 4 cyl with transmission.	Mini trucks	Isuzu (Japan)	100,000 per year	1981
1.8 liter diesel 4 cyl	Chevette	Isuzu	Small numbers	1981
1.3 diesel 4 cyl	S-Cars	Isuzu	NA	1983
1.8 liter 4 cyl	J-Cars	GM de Brazil	250,000 per year	1979
THM 180 automatic transmission.	Chevette	GM Strasburg (France)	250,000 per year	1979
Manual transmissions	J-Cars	Isuzu	250,000	1981
Ford				
2.2 liter 4 cyl	Cars	Ford-Mexico	400,000 per year	1983
Diesel	Cars	Toyo Kogyo (Japan)	150,000 per year	1983
2.0 liter 4 cyl	Mini trucks	Toyo Kogyo	100,000 per year	1982
2.3 liter 4 cyl	Cars	Ford de Brazil	50,000 per year	1979
Diesel 6 cyl	Cars	BMW/Steyr (West Germany, Austria).	190,000 per year	1983
Diesel 4 cyl	Cars		NA	1985
Manual transaxles	Front drive cars	Toyo Kogyo	100,000 per year	1980
Aluminum cylinder heads.	1.6 liter 4 cyl	Europe, Mexico	NA	1980
Accessory Motors	Cars, trucks	Ford-Singapore	NA	1984
Electronic Engine control devices.	Cars	Tashiba	100+ per year	1978
Ball Joints	Cars	Musashi Seimibu	1,000,000 per year	1980
Transmissions	Ranger truck	Ford-France	NA	Imminent
Trim	Ranger truck	Mexico	NA	NA
Trim	Econo van	do	NA	NA
Trim	Topaz (Fairmont, Zephyr)	do	(Prospective)	
Windshied glass	Light trucks	do	NA	NA
Chrysler				
6 and 8 cyl engines	Cars	Chrysler de Mexico	100,000 per year	1982
2.2 liter 4 cyl	K-body	Chrysler de Mexico	270,00 per year	1981
2.6 liter 4 cyl	K-body	Mitsubishi (Japan)	1 million	1981
1.7 liter 4 cyl	Omni/Horizon	Volkswagen (West Germany)	1.2 million	1978
Manual transmissions	Omni/Horizon	Volkswagen	500,000	1978
1.6 liter 4 cyl	L-body	Talbot (Peugeot)	400,000 total	1982
2.0 liter Diesel and 6 cyl.	K-body	Peugeot (France	100,000 per year	1982
1.4 liter 4 cyl	A-body (Omni replacement)	Mitsubishi	300,000 per year	1984
4 cyl engines	Cars	Peugeot	NA	1985

APPENDIX IV—FOREIGN SOURCING—Continued

[Partial list of known 1977–81 commitments by major U.S. automobile manufacturers to purchase foreign-made major components for use in domestic nameplate vehicles]

Manufacturer and component	Intended for	Source	Approximate number of components	Delivery beginning
Alumium cylinder heads.	2.2 liter 4 cyl	Fiat (Italy)	NA	1984
AMC				
Car components and power train.	AMC-Renault	Renault in France and Mexico	300,000 per year	1982
VWA				
Radiators, stampings	Rabbit	VW de Mexico	250,000 per year	1979
4 cyl diesel and gas engines.	Car	VW de Mexico	300,000+ per year	1982

NA=Figure not available.

Sources: Automotive News, Ward's Engine Update, Ward's Automotive Reports, American Metal Market, Detroit Free Press, Detroit News, Japan Economic Journal, and Journal of Commerce.

APPENDIX V.—TREATMENT OF JAPAN BY OTHER MAJOR AUTO-PRODUCING COUNTRIES

	Local content		Local production of Japanese cars and trucks	Tariff (percent)	Treatment of Japan
	DeJure	DeFacto			
Australia	Yes		X	35–57	
Belgium				[4] 10.8	Japan's voluntary export restraint (VER) holds its share to 20 percent of Belgium market.
Brazil	Yes		X	185–205	
Canada				[4] 10.8	VER around 20 percent.
France		Yes [2]		[4] 10.8	Customs prevents entry of more than 2½ percent of French market.
Germany				[4] 10.8	VER at 10 percent of market.
Italy		Yes [2]	X	[4] 10.8	Allows entry of 2,200 Japanese cars into market.
Japan			X	[3] 0	
Mexico	Yes		X		
Spain	Yes		X	68	
United Kingdom		Yes [1]	X	[4] 10.8	VER at 10–11 percent.
United States			Soon	2.8	VER over 20 percent.

[1] While holding Japanese companies to less than 11 percent of their market, the UK has negotiated for government-owned BL, Ltd. to build Honda Acclaims under license. They have also been negotiating with Nissan to build Datsuns there with 80 percent content.

[2] France and Italy have treated British-assembled Hondas as Japanese imports subject to their stiff quotas because they do not have 70–80 percent European content.

[3] Japan kept out auto imports with prohibitive tariffs on autos until the early 1970s. Since then they have relied on non-tariff barriers and have phased out their tariffs. Their product standards differ substantially from other countries. They individually inspect imported cars rather than follow the U.S. practice of examining a sample of cars and then accepting the manufacturer's self-certification. Dealers of Japanese cars do not sell imported cars, as is commonly done here. As a result of all of these, no foreign auto maker has been able to break out of the vicious cycle of low volumes and high margins for overhead.

[4] Value-added taxes applied to tariffs raise their effective rate to 13–14 percent.

[From the Business Week, Apr. 13, 1981]

Appendix VI

A BETTER WAY TO HANDLE AUTO IMPORTS

The U.S. automobile industry can make a strong case for some sort of protection against Japanese imports while it retools to serve the small-car market. But instead of slapping a tariff on Japanese cars or negotiating import quotas, Washington should consider a device that is rarely mentioned: requiring imported autos to contain a specified percentage of parts made in the U.S.

One big advantage of this approach is that it would create jobs in the U.S. auto centers without shutting of the profits of Japanese companies or making it impossible for U.S. consumers to buy the kind of car they want. And whereas a tariff would involve the threat of retaliation and a negotiated quota would call for some sort of quid pro quo, a local content requirement would cause a minimum of disruption in ordinary channels of trade.

Another point in favor of the requirement is that it would leave the free market to decide which U.S. suppliers got the Japanese parts business. Hot competitive bidding would put a premium on efficiency and reliability of products. The requirement, therefore, would not provide a shelter for imcompetent, high-cost operations—as a tariff would. And it would not protect companies that yielded to union pressure and conceded overgenerous wage and benefit increases. The competing company that held the line on labor costs would be able to carry off the business.

Practically every industrial nation in the world—except the U.S.—has imposed a local content requirement on imports for years. Detroit, of course, would rather have the comfortable protection of tariffs or a quota. But a local content requirement could help the U.S. economy without touching off a trade war.

[From the Automotive News, Feb. 18, 1980]

APPENDIX VII

END THE HYSTERIA

Heated debate over the future of imported cars in this market erupted during the recent NADA convention and quickly came to dominate the New Orleans sessions. A great amount of heat and not much light was generated.

Sentiment runs from one extreme to the other: All the way from keeping the market totally free to slamming the door. The stands taken seem largely emotional, based on gut reaction. We think it is time to end the hysteria.

Before it is too late, and before action is taken that is ill advised and could be sincerely regretted later, some sensible decisions must be made.

Now is the time to begin rational debate, aimed toward reaching an equitable decision on import participation.

We still believe that the AUTOMOTIVE NEWS proposal, set forth were a week ago, could well be used as a benchmark. To recap briefly, we think any non-North American automobile should be able to enter the U.S. with no restrictions so long as its volume does not exceed 50,000 units a year. But for each additional 50,000, local content on the total number of cars should be 5 percent. If an auto importer sold 50,001 cars, his cars would have 5 percent local content. If he sold 100,001 cars, his local content would go up another 5 percentage points to a total of 10 percent, and so on. The local-content requirement would reach a maximum of 50 percent when annual soles reached 500,001.

Such a program, we believe, could be implemented immediately, with one-fifth of the appropriate percentage applied right away and increased over the next five years until it reached the proper amount required by sales volume. This would give importers enough lead time to reach the required local content.

We would much prefer that all of the imports would accept this formula voluntarly or, at the very least, work from this as a benchmark.

What we fear is that the government will become involved and produce a complex "solution" that will turn out to be a problem all its own.

If what surfaced at the NADA convention is any indication of what lies ahead, there is going to be too much hotheadedness involved in sorting out the situation.We saw a lot of this—on both sides—at the NADA convention.

The issue must be defused and an equitable solution must be réached. There is not much time left.

APPENDIX VIII

UAW COMMENTS ON THE CBO REPORT

The CBO analysis of H.R. 5133 indicates that, with more realistic assumptions, the Fair Practices in Automotive Products Act would generate over a million additional jobs in the U.S. economy by 1990. Their model shows that the Act can create 5.5 jobs in the rest of the economy for every job it creates in the auto industry.

However, the CBO has plugged into their reasonable economic model a set of *unrealistic* assumptions about 1990:

1. The import share of the market will fall from where it stands today even if the bill is not passed.
2. The U.S. companies' foreign sourcing would not be affected by the bill.
3. No foreign auto company would achieve enough local content under the bill for its sales to exceed 100,000.
4. Japan would retaliate against U.S. exports on a massive scale if the bill is passed.
5. The bill would cause auto prices to rise by 6 percent.

The CBO's micro-level analysis also makes critical errors that lead to a gross underestimate of H.R. 5133's effect on jobs.

UNREALISTIC ASSUMPTIONS IN THE MACROECONOMIC ANALYSIS

The CBO's conclusion that H.R. 5133 would have a negative effect on employment and GNP depends on several unrealistic assumptions. The CBO has nonetheless developed a reasonable macroeconomic model which projects that by 1990 the bill would generate 520,000 additional jobs in the absence of retaliation. With more realistic asssumptions plugged in, over a million jobs would be created.

In final results, the CBO has minimized the benefits of the bill by assuming a very rosy future for the U.S. industry without the bill: the import share of the market would fall from where it stands today, and the U.S. auto companies would not increase foreign sourcing. However, the CBO's own discussion of those two issues in the text of the report does not justify either of those assumptions.

The paper also makes adverse and incorrect assumptions to offset the benefits of the bill: no foreign auto company would make any additional investments or purchases here; Japan would retaliate against U.S. exports on a massive scale; and auto prices would rise by 6 percent.

The error of the CBO's conclusions should become apparent after these five fundamental assumptions are closely examined.

IMPORT SHARE WITHOUT CONTENT LOWER THAN TODAY?

The CBO presents a table of projections for the import share of the U.S. vehicle market in 1990 in the absence of content (page 14). The projections range from 23.7 percent to 40.0 percent.[17] In comparison, even with Japanese cars restrained, imports have taken 27 percent of the U.S. vehicle market in recent months and achieved a record 31 percent of the car market in July. Yet, in calculating the bill's effect, the CBO uses only the extreme assumption of 25 percent and does not try the alternative assumption of 40 percent projected by Merrill Lynch Economics nor the 35.8 percent by Chase Econometrics.

If, in the absence of content, the foreign share would be 40 percent instead of 25 percent, the jobs at stake would double. The CBO was clearly remiss in not calling attention to this large downside risk.

NO LIMIT ON U.S. COMPANIES' FOREIGN SOURCING?

When making its estimate of the bills effect, the CBO assumes (pages 44–45) that it would have no effect on foreign sourcing by the Big Three. Yet, in an earlier discussion of the issue (page 25), it accurately explains that all three would have to change their plans to stay above 90 percent—on the basis of imported parts alone. Imports of all types of automotive parts are increasing rapidly. According to a recent Commerce Department repprt, the U.S. is currently importing 2.5 million engines and 1.7 million transmissions on an annual basis, compared to virtually none a few years ago. Recent surveys of auto industry experts conducted by The Detroit News and the University of Michigan predict continued acceleration of foreign sourcing.

Equally distrubing, the U.S. companies are also planning to increase imports of assembled vehicles. GM has recently announced that it will bring in 200,000 vehicles a year from Japan. Both GM and Ford have been negotiating to import hundreds of thousands of additional vehicles.

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[17] A recent study by a National Academy of Engineering panel, "The Competitive Status of the U.S. Auto Industry", July 26, 1982, considered the possibility that the import share could rise to 65 percent over a similar time period.

NO INDUCEMENT TO FOREIGN INVESTMENT?

The CBO believes that, rather than attempt to maintain their market shares here, all foreign companies would accept a ceiling of 100,000 on their sales here. This makes no sense in the case of VW, which has 70 percent content in the Rabbits it sells here and 40 percent overall. Moreover, Honda will begin with 50 percent content in the cars it will soon assemble in Ohio. It also seems implausible to assume that both Toyota and Nissan/Fuji would watch their sales fall from over 700,000 today to 100,000 by 1990 without even attempting to achieve as little as 25 percent content.

When foreign governments have made local investments and purchases a condition of local sales, auto companies around the world have consistently acted to protect their market share. In this case, the U.S. auto makret is the largest in the world. This market accounts for the largest chunk of the sales and profits of foreign auto companies outside their home makret. It seems safe to assume that they will not walk away from this market.

The CBO does not appreciate how quickly a company can accumulate substantial content. Japanese auto companies build many very different models along a single assembly line. Although the CBO assserts (page 3) that 75 percent content requires local production of both engines and transmissions, VW imports both. In fact, four years after announcing its decision to produce in the U.S., VW achieved about 70 percent content on Rabbits produced here.

Japanese auto companies will face considerable pressure to comply promptly with the bill as it is phased in over the decade of 1980's. To keep their place in the market with sufficient future local content, they must commit themselves to a schedule of large-scale projects almost immediately. In addition, the competition among each other will spur them to achievement of greater local content: Honda's current plans already put compliance within its reach; Nissan's soon-to-open truck plant puts it well ahead of Toyota. No major Japanese producer would be likely to withdraw from the competition to retain the U.S. market share it has worked so long and hard to obtain.

6 PERCENT HIKE IN CAR PRICES?

Because the U.S. market would have much more competition than the CBO projects, their prediction of 6 percent higher car prices is too high. In the CBO's analysis, foreign companies' competition with the Big Three would be drastically curtailed: their sales would amount to 3.75 million by 1990 in the absence of content, but only 1.35 with content. Since foreign companies would be able to maintain their current shares of the market, such price increases would not occur.

In drawing conclusions about future prices, the CBO relies on analysis done under contract by the import dealers' association in 1979 (footnote 9, page 21). It dodges (page 33) any analysis of price increases during the more recent and pertinent period. Since restraints on Japanese car exports to the U.S. began in early 1981, list prices of U.S. cars have risen at a 5 to 6 percent rate—less than the nation's inflation average. Moreover, large and expanded rebate programs have meant effective price increases of around 3 percent. Announced price increases for this fall's models portend continued moderation.

THE RISK OF RETALIATION?

The CBO claims that retaliation is a "highly probable outcome" (page 4) that will nullify the job gains from H.R. 5133. As a practical matter, the bill would affect the plans of companies based only in Japan—and the U.S. The CBO assumes that U.S. exports would be cut by $7.6 billion to match a $7.6 billion reduction in U.S. imports, but undertakes no analysis of Japan's trade. The assumption that such massive retaliation is likely simply cannot be supported by a careful analysis of Japan's trade and the political context of auto policies around the world.

Last year, the U.S. had a deficit in auto trade with Japan of $13 billion out of a total bilateral deficit of $16 billion. So far this year, the overall deficit has widened even further to an annual rate over $20 billion.

Japan has never retaliated against the dozens of countries whose auto restrictions are much tighter than H.R. 5133. Indeed, to achieve or maintain their market presence, Japanese auto companies have invested in many of those countries. In the U.S., as elsewhere, once the Japanese companies have begun to comply in earnest, the Japanese government will be extremely reluctant to pursue a GATT complaint.

Japan could not impose trade sanctions against the U.S. without first going through GATT procedures. In practical terms, even if Japan could win the legal arguments, it has little room to take action against the U.S. If it brings a GATT complaint, the U.S. could file countercharges against the auto policies of many other GATT members in Europe, Australia, Indonesia and Latin America and Japan's cooperation with them. Japan could not win a GATT ruling against the U.S. unless these other policies were ruled out of bounds.

As a practical matter, Japan buys from the U.S. only what it cannot make for itself: raw materials or products using technology it does not yet have. For many of these products, the U.S. is Japan's predominant supplier. For those imports for which Japan has alternative sources, those source countries have auto policies far more restrictive to Japanese auto imports than the proposed U.S. legislation: Australia, Argentina, Brazil, Indonesia for raw materials; European countries for manufactured goods. Why would Japan retaliate against modest U.S. auto content legislation by buying less from us and more from countries with auto policies which limit their exports more severely?

CRITIQUE OF THE CHAPTER ON MICROECONOMIC ANALYSIS

Turning to the CBO's chapter on microeconomic analysis of the jobs at stake, we find more large errors. Just as in the chapter on macroeconomic analysis, these errors systematically bias the positive results of the bill in a downward direction.

The CBO estimates that the additional cars produced here under the bill would require about 200 hours to build. It finds that, although the UAW analysis was not put in that framework, we have implicitly assumed two-and-a-half times that many hours. To reconcile the difference, the CBO argues that we failed to make several adjustments which would have reduced our estimate to 225 hours. We find the CBO's evidence and arguments to be quite flawed with respect to the two largest adjustments.

In making its biggest adjustment, the CBO relies on incorrect and unrepresentative data from Ford Motor Company. Arguing that "marginal labor requirements are less than average labor inputs," it uses 1976–1980 Ford data to conclude that we have overstated labor requirements by 60 percent. In fact, the CBO has used Ford's U.S. sales figures and not its production figures and used average employees-on-the-payroll figures during a strike year (1976). When production figures are used and output lost due to the strike is included, Ford's marginal vehicle output to employment ratio between 1976 and 1978 is 12—less than its average ratio of 13.4. A similar exercise for GM's vehicles per production worker[18] also yields a marginal ratio (10.2) less than the average ratio (14.4).

Even if the numbers had supported their conclusion, the CBO has used faulty methodology in making an industry-wide projection for 1990 based on two-year cyclical swings within one large company. During such a short period, companies often adjust overtime or days worked rather than employment. For example, average overtime in the auto industry rose from 2.6 to 6.8 hours per week between 1975 and 1977. This results in the CBO's measure of vehicles per employee changing more than vehicles per hour, which is the pertinent ratio.

Over longer periods, companies as a whole contract (or expand) by closing (opening) plants and reducing (increasing) employment in both production and overhead. In addition, of the thousands of companies involved in the auto industry, many will go out of business altogether, particularly if the bill is not passed. By the same token, if the bill is passed, major foreign auto companies would begin to operate plants here. All of these considerations favor using the average employment to output ratio when making the 1990 estimate of added jobs from added production.

The CBO's next largest adjustment factor—to exclude most replacement parts—is similarly mistaken on both empirical and practical grounds. It relies on a report that replacement parts at retail amounted to $36 billion in 1981. It then assumes that both the vehicle and the replacement parts industries have the same ratio of jobs to value of retail sales. However, that assumption is invalid since it is well-known that to buy all the parts for a car separately at retail would cost several times the price of that car.

Although the CBO finds that the value of retail sales of replacement parts comprises 28 percent of the total for replacement parts and cars, it reduces that to a 20 percent adjustment factor. We believe that no such adjustment factor is warranted. Replacement parts are not directly covered by the bill, but the CBO concedes that the locations of some replacement parts production will be influenced by the location of production for original equipment. On the other hand, we believe that for the vast majority of replacement parts, the location of original equipment production will determine where they are produced as well. Therefore, estimates of the effect of the bill should include virtually all replacement parts workers in the affected employment base.

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[18] The number of GM's total U.S. employees was not published for 1976.

Although we cannot accept the two large adjustments discussed above, we can accept two small adjustments: workers making heavy trucks and buses should be excluded; and the additional cars produced will probably be smaller on average than the average cars produced in the U.S. last year. With these two adjustments, our estimate for the hours per additional car produced still exceeds twice the CBO estimate.

Our rough estimate of over 400 hours per small car is entirely consistent with information published by the U.S. auto companies. For example, GM produced about 9.5 vehicles per employee[19] in 1981, and its outside purchases amounted to over twice its payments to employees. Since employees at GM suppliers are paid less per hour than its own employees, total employment in supplying (and subsupplying) GM is substantially more than double GM's employment. This difference in labor costs probably offsets the adjustment for size of cars and GM employment outside of cars and light trucks. Thus, an American job is created by fewer than every four small GM vehicles produced.

Indeed, it is important to note that the "industry studies" figure of 175 hours per car—which the CBO goes to such lengths to "reconcile" with the much larger figure implied by BLS data—is conceptually inappropriate for determining the number of jobs related to an increase in vehicle production. Whatever its relevance to company cost accounting—the use for which the "industry studies" approach is intended—this approach is inherently unsuited to employment analysis, since it greatly understates employment impacts. Where in the "175 hours," for example, are the jobs of distribution sector workers who transport components from parts plants to final assembly? Where are the jobs of workers who make machine tools purchased by the auto companies for use in the manufacture of vehicles? From the standpoint of employment analysis, there is no justification for overlooking these and countless other jobs directly related to an increase in vehicle production.

A proper analysis of the direct jobs impact of an increase in vehicle production should include all such "direct" workers in the employment base, including truck drivers, machine tool builders, etc. For purposes of determining this base, BLS employment data—without CBO's spurious and unwarranted "adjustments"—are far more appropriate than the "industry studies" data cited by CBO.

After failing through unjustified adjustments to reduce the BLS data below 225 hours, CBO arbitrarily "splits the difference" between that 225 hours and the 175 hours of "industry studies" (also adjusted), and utilizes 200 hours-per-vehicle in its employment impact analysis.

In summary, our review of both the macroeconomic and microeconomic analysis by the CBO shows that its estimates of the jobs at stake are substantially less than half of what is appropriate. Since their analysis still shows 520,000 jobs at stake, an accurate estimate would exceed a million jobs.

Chairman GIBBONS. Thank you, Mr. Fraser. I will be brief.

I have no criticism of your position or your success. You have been a very successful leader for your constituents. In fact, you have been so successful that the wages of your people are now up 70 percent higher than the average American industrial laborer.

I guess one of the penalties of success is that you have priced yourself out of their pocketbook. The same is true, of course, in the steel industry. They are even higher than autoworkers. I don't want you to think that is a criticism of you personally. As I say, you have been very successful, but success does have its cost, too.

Mr. Fraser, as I look at the industry, other than the observation I just had, automobiles have been a victim of very high interest rates, exorbitant interest rates by past standards, and the fact that the management was not as attuned as they should have been to the right product mix for the American consumer. It seems to me that the facts bear out this argument.

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[19] Some 522,000 U.S. workers at GM produced 4,611,000 vehicles in 1981, for a ratio of 8.83 vehicles per worker. We've made a rough adjustment for the fact that 6.9 percent of GM's worldwide sales—no employment breakdown is published—were derived from non-auto operations.

Domestic sales have declined since 1978 by 4.5 million units, while imports have increased by 460,000 units. Therefore I reason, as must other people do who have examined this, that imports are only about 10 percent of the drop in the domestic sales. This means that imports have had a relatively small impact, only 10 percent of the drop in domestic sales, and that the real reason is that the American consumer can't afford to buy the product or doesn't want the product because of its price or because of its characteristics.

I don't have any other questions. If you want to respond, will be happy to have you do so, or I will turn it over to Mr. Brodhead.

Mr. **Fraser**. Mr. Chairman, with respect to that differential, I hadn't heard the figure as high as the one you cited between the average manufacturing rate in autos. I admit it is substantial, but you have to take into account, because our productivity increases at a much higher rate than industry generally, the unit labor costs. An examination of the unit labor cost would not show that differential.

In addition to that, I wish to make a point about how the workers are faring. One might reach the conclusion that everyone who is working in manufacturing of autos is getting wealthy, but the fact of the matter is that if you look at the wages of the average person in manufacturing—I am talking about real spendable income, purchasing power—the spendable income of a person working in manufacturing, you have to go back to 1966 to find the level of that purchasing power. In other words, the person in manufacturing today has the same purchasing power as he or she had in 1966.

When you look at autos, we have not made any advances in terms of real purchasing power. Our spendable income, our purchasing power is the same as it was in 1974.

Chairman **Gibbons**. If it is any consolation to you, this Member of Congress is a lot worse off today than he was in 1966. I don't expect any sympathy, but all of us have that same problem.

Mr. **Fraser**. You have my sympathy, but I need your help.

Chairman **Gibbons**. All right, sir. I won't delay you.

Mr. Brodhead?

Mr. **Brodhead**. Thank you, Mr. Chairman.

Mr. Fraser, your union, of course, represents in addition to the workers in the United States the workers in Canada. There has been some discussion about the treatment of Canada under this bill, both in the original bill and in the revised legislation, the substitute legislation.

I wonder if you could comment, based on your expertise dealing with Canada, Canadian workers, on what the impact of this bill would be, if enacted, on the Canadian auto industry, on jobs in Canada, and on relations between Canada and the United States.

Mr. **Fraser**. First, Congressman Brodhead, we don't want to take advantage of our Canadian brothers. When this legislation was first proposed, it referred to the North American continent. By North America, we are not talking about Mexico. We are talking about the United States and Canada.

As the discussions proceeded, it became obvious to us that this was a legislative impossibility, that we simply couldn't legislate in our Congress for Canada. So we reluctantly withdrew from that position.

We don't see this having any negative impact in terms of Canada as it relates to the auto pact. If you wouldn't mind, Congressman Brodhead, I would like Lee Price to make a couple of technical points as it relates to this question.

Mr. BRODHEAD. I think the committee would be interested in hearing that.

Mr. PRICE. The issue of Canada is a troublesome one, but it is somewhat ironic that one of the major critics of the way we have dealt with Canada has been the administration. In the original bill they criticized the treatment of Canada because they said it was treating one country differently from another, and that that was not giving others most-favored-nation treatment.

Then political realities forced us to accept changes in the bill that didn't give Canada special treatment. Now we are said to have violated the auto pact and that it will end the pact. I think it is important to understand what the pact is and what this does in respect to the pact.

The auto pact has set up free trade between our two countries. Both of us recognize that we work more efficiently by having no tariffs and no impedence to original equipment parts and newly assembled cars going back and forth.

For all intents and purposes, General Motors, Ford, Chrysler, and other U.S. companies, treat Ontario and Quebec as Ohio and Michigan. They are integrated into their production and sales network.

Roughly two-thirds what is assembled in Canada comes back here to be sold; two-thirds of the cars that are sold in Canada are made here; two-thirds of the value of the parts that are put into Canadian cars come from here. It is just totally integrated, and that situation benefits both countries.

We fully intend for that to continue. I think the Canadians want that basic understanding of the pact to continue, free trade, no interference and an integrated product and sales market.

However, as to the technical matter for what the pact does, it says that no country on either side should try to take advantage of the other country. At the same time, both countries are recognized to be interested in how much auto production they have. In the auto pact, there are special safeguards for the Canadians to have content.

It has specifically in there that Canadians can require 60-percent content for a company to get free trade access for parts and cars that it brings into Canada.

Since the signing of the auto pact, Canada has taken several actions that improve, enhance the content of cars made there, or companies producing there.

They have established a tariff rebate scheme for countries to get a reduced tariff on auto parts, if they buy Canadian parts or produce there.

They have made an agreement with Volkswagen to make parts there in order to get duty-free treatment for everything that they bring into Canada.

They have set up the Foreign Investment Review Agency that has been negotiating with Renault, with the apparent intention of seeing that they do more production in Canada.

Furthermore, they have even recently been meeting and considering measures to have the U.S. companies raise the content there.

All of those things have been done to raise Canadian auto production, and the United States has accepted those under the pact.

We fully expect that if the United States takes measures to improve, enhance auto production here relative to our market here, that the Canadians will accept that. They may also decide to take further measures to enhance the content there, but we don't think that our passing this bill will in any way undermine the auto pact as an understanding that we want integrated production and sales between our two countries.

Mr. **Brodhead**. Thank you. One further question. I will try to be brief.

Some of the criticism that has been directed toward this bill questions how many additional American jobs would be created by the bill. Of course, in order to project that you have to project what you think the trendline is going to be of imports coming into the country.

I note from your testimony that you have different views on that than does the administration, who testified yesterday and the day before with respect to what you see as the trendline in terms of increased imports.

How do you see that, Mr. Fraser? You talk 27 percent now. Where do you see without this legislation the trendline of imports going over the next few years?

Mr. **Fraser**. I would think it is not unrealistic, absent this bill, that by the turn of the decade you could be near 45 percent of the American market.

Mr. **Brodhead**. I suppose a factor in that would be the increased involvement of the American companies in bringing imports into the United States. That seems to be going up, does it not?

Mr. **Fraser**. And also out-sourcing, those two factors. You see, the unfairness in this situation is that after the Second World War, when the European market opened up for the American cars—and we could have produced them here and shipped them over there but we didn't—we went where the market was. We are trying to say to the Japanese you should do the same thing as we did in Europe after the Second World War. I suppose in a perfect world, we wouldn't be here today, but the world isn't perfect, Congressman Brodhead, as you know.

I watched on television, as I am sure many Members of Congress did, the massive demonstration in Tokyo by the Japanese farmers. They were yelling, they were screaming, they were acting just like autoworkers. They were protesting, they had banners and they had signs and placards in both English and Japanese. The placards said "Keep out American citrus," "Keep out American beef," and they do it without any compunctions at all. But yet we worry ourselves to death that we are violating the sacred principle of free trade, when that trade isn't at all fair.

All we want is fairness for our country and fairness for our country's workers.

Mr. **Brodhead**. Thank you, Mr. Fraser.

Mr. **Friedman**. I wonder if I might elaborate briefly on the question you raised, Congressman Brodhead, concerning the future trend of import share if nothing is done. I believe it is an absolutely vital question. We have seen in the last 3 years the import share of imported vehicles just skyrocket, and in the months of July and August, as you will see in our prepared statement, imports captured nearly 33 percent of our market.

Mr. **Brodhead**. Thirty-three percent?

Mr. **Friedman**. Yes, sir. And I believe the committee should be fully aware that nearly every serious analyst of the auto industry projects that if nothing is done, if this Nation does not make it a serious article of its industrial policy to preserve an auto industry as part of its industrial base, if nothing is done, we face further massive increase in the import share in the years ahead.

It is difficult to put a precise figure on it. One person's number is as good as another. But the trend, the direction is very clear, and the magnitude of the potential erosion of our auto sales, of our domestic share of the market, and the increase in the import share is in all probability going to be very, very substantial.

Mr. **Brodhead**. Thank you. Thank you, Mr. Chairman.

Chairman **Gibbons**, Thank you, Mr. Bailey.

Mr. **Bailey**. Thank you, Mr. Chairman, who I love like a brother, but need to take issue with something that I think just has got to be emphasized. This tendency to blame American unions and to blame American management for lack of productivity, for poor quality, for poor marketing practices, for being noncompetitive, for being nonimaginative, has simply got to stop. It is not true.

The truth in fact is that if there is any responsibility to be laid at any doorstep, it has been the inability of our Government to coordinate trade and domestic tax and regulatory policies in light of a changing world. That is where the fault lies. It doesn't lie with the American worker.

I don't know of a single credible source, and I would like to thank you, Mr. Fraser, for making the point here today about the automobile industry, and I would like to stress that it applies also to the steel industry. I would like to stress that it applies to the mining industry. I would like to stress that it applies to aeronautics. This question of productivity, of return on investment, plant and equipment, that somehow unions and workers have resisted reinvestment or modernization of plant and equipment in the United States of America is not true. That is false.

Given the quality, given the return on investment, given the replacement and improvement of capital goods and tooling, etcetera, the American worker is the best in the world. When Volkswagen of America came to this country and sought workers and management, they went to the American automobile industry. They got good people, and it is to their credit.

The truth in fact is that American workers in this society do have a right to protect labor standards and safety on the job and income and job security. We have built it for our people and it does mean something. We don't have to adopt some Japanese way of doing business because we want to go out and deplete or gut or destroy industries across the world to maintain our market share or to take advantage of it.

I don't think there is an American worker or an American union—and you occupy a unique position—that isn't willing to compete or isn't willing to say that we will go out and fight for our share of the market, and we have made mistakes and we have made errors.

Part of them have been due to variables beyond our control, energy changes that affected consumer preferences. You made reference to that, and we have decided to retool and to do all those things, but the inability of our Government to go out and write tax policy that encourages reinvestment—because we don't want the planning cycles or the planning institutions that the Japanese utilize—doesn't mean we have to subjugate our industries and our people and our society to abuse.

You said it very well, and I compliment you for that also, Mr. Fraser. In an ideal world this would not be an ideal way to go. If we didn't have a legitimate complaint about the nature of capital formation problems and Government symbiosis, or Government cooperation with industries that we face in other countries, then you couldn't justifiably argue that we are the victims of those kinds of policies. So I compliment you.

I happened to work, incidentally, in Chevrolet, Warren. I worked in General Motors Hydramatic. I have worked in those plants, and I will tell you something—those jobs are difficult. Sometimes what they do to you in an 8-hour shift, there are a lot of folks running around here with these white collars on that wouldn't want to work in that job, I will guarantee you, and for $50,000 or $60,000 a year. I have worked at it, and I know what it is like.

I would like to clear up one more thing also, and I will finish. The steel industry in the United States of America has been put in the position it is in largely because of our Government policy, not because of our managers and not because of our union. It is not fair to give those economic participants out there who are largely the victims of Government policies, the responsibility when that policy fails. When we try to consider legislative remedies, it is not fair to put those people in those categories, because we somehow don't want to face the uncomfortable responsibility of doing something about a difficult situation. That is not just.

Those steel workers in the United States of America produce steel with less improved equipment, and do better at that job per hour than any steel worker in the world, and they ought to be given credit for it. It is not fair to say because they are pushed back or subjugated or controlled by a government, be it domestic wage policy, be it some attitude toward collective bargaining, or be it some attitude of export of capital and technology around the world to build democracies worldwide. Those are good and laudable goals. That is fine. But don't hold our unions and hold our management responsible for it.

I thank the gentleman for coming here. I support his arguments concerning his position. I think he has been very honest. It is not an ideal measure, but it is an American response to abuse, and the Japanese, who are listening, ought to listen very carefully, because we are getting sick and tired of it.

Chairman GIBBONS. Since the gentleman's remarks were obviously directed to me, I think it is appropriate to point out that the official statistics of the U.S. Government showed that in the second quarter of 1982 we ran a surplus of $39.7 billion in capital goods, Mr. Bailey, that is in capital goods.

Mr. BAILEY. Mr. Chairman, with all due respect.

Chairman GIBBONS. It doesn't show that this white-collar worker is speaking down to blue-collar workers. It just shows you that this white-collar worker is going to protect the rights of all Americans.

Mr. BAILEY. If the chairman is sensitized to feeling that I was directing the white-collar remark at the chairman, I am not. I think he knows of the respect and affection I hold him in. Quite frankly, there isn't anybody that works any harder than I——

Chairman GIBBONS. I just want to point out we ran a surplus in capital goods of $39.7 billion while at the same time in the very high-paid auto industry we ran a deficit of $19 billion.

Mr. BAILEY. Mr. Chairman, let me say this, and I will finish.

Chairman GIBBONS. There is something there.

Mr. BAILEY. Let me say I don't agree with you.

Chairman GIBBONS. These are facts.

Mr. BAILEY. As I said, I have great affection for you and I respect you, but I will say this about your remarks concerning capital goods. I can sit here and bore everyone in this room with a litany of examples. I will take the machine tool industry—ABC did a very nice public thing on Japanese policy there.

I can sit down and I can evaluate antitrust laws, and then we can look at where the trends are going, or we can sit down and talk about targeting industries, or we can talk about research and development and the Ministry of Trade's design and plan for Japan. I admire them for it but I don't want their form of free enterprise because, as Mr. Downey very correctly stated in a conversation with me earlier today, free enterprise it ain't, although my grammar is not as good as his.

I would have to say that I think, Mr. Chairman, that the trends are ominous. We have little sectors of our economy that are picked out. There is a great deal of cooperation in everything from financing to research and development, tax advantages, et cetera, in the Japanese system. We find it in the French system, we find it in the German system.

If the only thing, through sadness and error and not because he knew what in the hell he was talking about, that Karl Marx ends up being right about it might be some kind of free world trade. It is ironic that it is going to be caused by a new form of rising state capitalism and not by us and we need to respond to that threat in the name of, for the benefit of free enterprise.

Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Downey.

Mr. DOWNEY. Thank you, Mr. Chairman.

Mr. Fraser, before I ask you some questions, there are a few points I want to make. I don't want to take a lot of time with the statement, but I think that there are a number of points that need to be made about what the administration testified to yesterday on this entire question of purity.

Ambassador Brock said that indeed the administration was not pure when it came to questions of protectionism. That is a telling point, because if one looks at this administration's view—sugar, for instance—one would have a hard time reconciling the quota that will cost the American consumers an additional $1 billion that was politically inspired.

There has been concern that the domestic content provision that you and I support would do violence to the GATT. So does the Caribbean Basin Initiative. The administration is prepared to ask for a waiver.

When it comes to trade with the Japanese, the Commerce Department is prepared to preclude long-line finishing, which I am delighted they are about to do. They should have done it a long time ago, north of Cape Lookout. But they did it now because they wanted to trade a vote with a colleague of ours from New Jersey on the recent veto override. So the question of protectionism and purity is not at issue here because this administration's virtue is, well, somewhat cloudy.

Second, with respect to the real world, in France they just don't allow as many Japanese cars to come there. In Great Britain they just don't allow them in the country. The gentleman from Pennsylvania eloquently argued the case for the falsity involved in this entire question of who is at fault. Let's all claim some of the credit for the failure of American industry.

The fact is this country is without an industrial policy. It makes industrial policy by the seat of the pants and on an ad hoc basis. That is what we are doing here today. I happen to think the action that we are about to take is a correct one, but it is necessitated because we don't plan. It is necessitated because we have these mindless discussions about free and fair markets, competition and noncompetition.

The world is riddled with examples of where companies and countries require domestic content, and that market shares and jobs be shared in an international way.

You, Mr. Fraser, pointed out the case of the PC-3 Lockheed airplane as well as one of the F-15 from McDonnell Douglas. The Japanese require domestic content as part of their airplane contracts with the United States. Their entire history, be it computers or aircraft, is to get a piece of the action.

Now we need to recognize also in this environment that we are spending $20 billion this year on unemployment compensation. A significant sum of that amount goes to your members. We are going to pay one way or the other; the American people are going to pay one way or the other. There are a number of points that have been raised by critics of this bill that I would like you to specifically address.

The first is that we are not responding to an increasing domestic share of the market, but rather we are here today concerned about another problem we are not addressing, and that is the recession. Mr. Gibbons pointed out that there are additional jobs, jobs lost and cars not purchased because of the recession, not because of the increasing share garnered by the Japanese. Your response to that point, Mr. Fraser, please.

Mr. **Fraser**. About 2 years ago I thought the principal culprit was high interest rates. Unfortunately, even if interest rates should come down substantially, in my view the auto industry will not make a recovery until the Nation's economy turns around.

Obviously, with the huge unemployment we have, those people aren't going to buy automobiles, but now what is happening is that those people who are still employed are becoming extremely apprehensive about their future, their future job security, their future income. The automobile is a postponable purchase, and they are just staying out of the market. There must be tremendous pent-up demand there. But they will not come to the marketplace unless the Nation's economy first turns around, even if you have a reduction in interest rates.

Mr. **Downey**. The second question, a point that Ambassador Brock made, is that this would cost American consumers. Their estimate is, $5 billion and he didn't specify the amount of jobs. Your comment to that.

Mr. **Fraser**. Surely. I read of Ambassador Brock's statement, and I think he probably gleaned that information from a Department of Commerce study. We tried to get the details of that study and were never able to. It was sent over to the CBO and they discarded the study as being flawed.

The CBO study claimed that this legislation would result in a price increase of 6 percent, but it was based on a faulty assumption. It was based upon the assumption that this is a restrictive quota bill, and that at the turn of the decade the imports would be down to 25 percent, therefore reducing the competition, and obviously putting pressure on prices.

There is also the Congressional Research Service study, and it predicted that the price increase would not be anything along the lines Ambassador Brock suggests. It would be 4.3 percent, as I recall.

Let me make one other point. When the agreement was entered into with Japan, the voluntary restraint agreement, everyone predicted a sharp rise in the price of cars ranging from 10 to 15 percent. It is interesting to see what has happened in the past year. The increase in car prices last year was 2.9 percent, less than half of the inflation rate in this country. This morning's paper carried the news that Ford announced its pricing policy for the new models. GM is at 1.9; Ford will come in at about the same place.

So the claims that were made, the same kinds of claims that were made relating to the voluntary agreement with Japan, certainly were not borne out by the facts. I don't think will be borne out by the facts here.

Mr. **Downey**. The last point I want to make is one that Ambassador Brock also made. He said to this committee: Why should we single out—particularly he was pointing to my colleague Mr. Jenkins who has textile industries—why should we single out the automobile industry for this special attention? Why do they need the help when there are others suffering?

Well, this morning the Energy and Commerce Committee voted by voice vote to approve House Joint Resolution 600. This legislation regards the rail strike. The resolution requires the Brotherhood of Locomotive Engineers to return to work, and it dictates to them the terms of their contract. This bill will probably be on the President's desk this afternoon, and despite the fact that this is virtually unprecedented intervention in collective bargaining, the Congress is willing to take this step to force workers back to work.

It seems to me the least we can do to help your members get back to work is to pass this legislation, too. Thank you.

Mr. **Fraser**. Congressman, if I might just for a second comment on your references to the auto policy of other nations—and this goes to this whole question. If this were a perfect world, Congressman Bailey—we probably wouldn't be here. Let's just run through what is happening around the world.

Great Britain has a gentleman's agreement with Japan for 11 percent of the market. Germany became disturbed last year because of increased sales of Japanese cars. They have an agreement for 10 percent. In France they were at 3 percent but Renault had a bad year so they reduced it to 2½ percent. In Italy they allow in 2,200 cars a year.

Now, because all those markets are so restricted, those cars are going to find their way to our country, unless we take like measures, but we are not trying to be as restrictive as they are. We say bring the cars in. Build 2 million cars in the United States, and then we will go head to head in the competition. Come on over here and compete. It is not nearly as restrictive as a lot of the practices that are going on in nearly every industrial nation in the world.

Chairman **Gibbons**. Mr. Jones?

Mr. **Jones**. Thank you, Mr. Chairman.

Mr. Fraser, I welcome you to the committee. I have told many other people but I want you to know and I want the record to show that I think you are truly one of the great leaders of this country, certainly one of the most intelligent and broadminded leaders of the labor movement, and you have been very successful for those in your union.

I do have a difference of opinion on the approach to this particular problem. As you know—and we have discussed this—I am concerned about setting arbitrary limits and the reaction to those arbitrary limits by others among our industrial competitors in the world. The approach that I would prefer would go by the general theme of reciprocity, where we would insist on fair trade, and we would have a mechanism to react to unfair trade practices in any sector of the economy.

The question I asked Mr. Ottinger earlier today was what other industrial competitors do we have that have a domestic content statute or law similar to the one we are considering. He mentioned Brazil and Australia, which are not exactly our most competitive opponent in the automobile world market.

Do you have any concern, if we set this kind of arbitrary limit, that we will have some retaliation from other countries in the manufacture of things such as farm machinery, which, of course, is also organized by UAW? What if they set domestic content laws in Europe or elsewhere for the importation of farm machinery. That would be a serious blow to a number of jobs in that sector of our economy.

Mr. FRASER. I don't think any country in Europe would be affected by the content legislation that we are proposing, Congressman. You are correct. We do represent workers in the farm machinery, road construction, equipment industry. The chairman made reference to our surplus in export capital goods. Our Caterpillar workers and John Deere workers are in that group, and incidentally, they are paid the same wage or higher wages than the autoworkers, so it certainly has no bearing here.

In terms of industrial countries, I would name Australia and Mexico, but then I would go on, Congressman Jones, to say that they find other ways of doing it. I just ran the litany. Rather than have content legislation, Germany has 10 percent, France has 2½ percent, Italy has 2,200 cars, Great Britain has a gentleman's agreement—and obviously when the Japanese are restricted in those markets they are going to come over.

You may have read what our friends in Canada did recently. They do what the Japanese do to us; they just didn't let the cars get out of the port in Vancouver until they got an agreement with the Japanese.

Mr. JONES. And we also have a quota limitation, voluntary though it may be, with the Japanese.

The point was brought up earlier about the economy being the villain more than unfair imports or unfair trade coming from imports, and CBO points out that in 1982 the sales of imported cars is off nearly 11 percent. Sales of domestic cars is off about 14 percent, so in terms of total sales, both imports on a percentage basis and on a volume basis are down, as well as domestic cars, and, of course, one of the major concerns that we have found—in addition to the interest rates—is the sticker price of any automobile, particularly in this depressed economy. So, automobile sales in general will be down until the economy gets going.

I am not sure that we are going to improve the situation by any kind of restrictive or protectionist legislation, are we? Because the studies such as CBO or any of them that predict an increase in the price to the consumer, the sticker price, with the economy remaining depressed, coupled with high interest rates, will still keep the whole industry depressed.

It just won't be selling cars.

Mr. FRASER. First of all, I certainly agree with you on the interest rates, although, as I said before, there is this added factor, and that is the deep recession the country is in. Even if interest rates go down appreciably, I don't think you will see a recovery in the auto industry until the Nation's economy makes a recovery.

I wish that Congress would look at the yen-dollar relationship. There is something wrong there. The yen was at 180 to $1 as late as 1978, and during that period you may recall the Datsuns were on our shores, and they could not move them. The Toyotas were on our shores, and they could not move them. So that is an unfair advantage to the Japanese.

Now, unquestionably, I never argued that our rates of pay were not higher than the Japanese, but they are moving much closer to us over the past, say, 10 years, and frankly when you look at the industrial scene in Japan, and look at the proficiency and the excellence of performance of the Japanese autoworkers, they are really underpaid. They are going to be pressing—I am sure they are going to be pressing hard in the years ahead—to close that gap between their wages and ours, as they have closed them in the last 10 years. And I think that in the years ahead there will be real competition, price competition, between ourselves and Japan.

Let me talk about the CBO study. I will come back to it. It said there will be a 6-percent increase in prices, and I make the point, and I will make it again, that was based upon the assumption that there would be less competition than there now is, because this would act like a quota bill, and there would be many, many fewer cars coming into this country than there likely will be.

In fact, if I recall the CBO figures, they said there will only be 1½ million cars, and if you let it take its natural course, there will be about 3½ million imports in this country.

So we say the base on which they made their price assumptions is false. There is going to be much, much more competition than the CBO said there will be.

Mr. **Jones**. Let me say I guess the villain in all this is Japan, and Japanese economic policies and trade policies have made a number of major blunders. The automobile industry is just one example of it. A number of us were in Japan about the time you were, and we tried to convince them that they ought to be building assembly plants, or at least parts plants in this country. If they didn't, they would face this sort of thing, and so what we predicted would happen is coming to fruition. But the fact remains that there is a lot of historical data and a lot of expected results of this kind of legislation that would indicate there will be retaliation in other areas.

The other part of the CBO study you referred to indicates that there would be an increase in jobs in the automobile industry resulting from this legislation, but over all there would be a decrease in jobs of, I think, 150,000.

So I think that is something we have to be concerned about.

Second, Tom Downey brought up the question, why should the automobile industry alone get this kind of protection when other industries are also ailing, and my concern is that we won't be able to hold the line.

Once you start down this road, as we did in Smoot-Hawley 50-some years ago, it is hard not to have more snow get on that ball as it goes down the hill.

My reading of what happened in the 1930's is that it was a direct result from the Smoot-Hawley tariff of the late twenties.

I am genuinely concerned about whether or not this approach to a very real problem in your industry is going to be counterproductive, and may lead to greater problems for the economy at large.

Mr. **Fraser**. If I thought this were another Smoot-Hawley, I certainly would not be here. Smoot-Hawley was a tragic mistake, I think, in the history of our Nation. As you know, it practically dried up all trade among nations. It applied to all goods, unlike this legislation.

Let me direct a couple of remarks to retaliation. The Japanese don't retaliate against the French. They have got a quota of 2½ percent, much more stringent than anything we are suggesting here. They still buy their Airbus.

They still trade with Australia. Australia for years has had 85 percent content legislation, and the Japanese still trade with them, and the Japanese, Congressman, as you know, buy from us only what they need and only what they can't produce and make for themselves.

In addition to that, let's assume the worst. The Japanese would have to file a complaint with GATT. They have never done it before, because I think it makes them vulnerable. If they filed a complaint with GATT, and then we could countercharge and get an examination of the auto policies of all of the other countries to which I referred before; I don't think the argument of retaliation is a real one.

Mr. Jones. Thank you, Mr. Chairman.

Chairman Gibbons. Mr. Frenzel?

Mr. Frenzel. Mr. Chairman. I want to yield to the distinguished gentleman from Michigan, Mr. Vander Jagt.

Mr. Vander Jagt. I thank my colleague from Minnesota for yielding to me, to give me this opportunity to extend a very sincere welcome to Mr. Fraser to our committee. I am sorry I was not here to hear your statement. I have had an opportunity to read it, and, as a Congressman from Michigan, I can tell you that you describe with accuracy and without exaggeration the depth of the problem of unemployment in the automobile industry.

Might I also say that shining through the statement is a very real and genuine commitment to the jobs of your people. I have found that to be true on a personal basis. When problems of retaining UAW jobs in the Muskegon district, in my district, arose, I found you to be responsive and with a real deep and genuine concern, and I appreciate that very much, as I appreciate your appearance here this morning.

Thank you, and I thank the gentleman from Minnesota.

Mr. Fraser. Thank you very much, Congressman.

Chairman Gibbons. Mr. Pease?

Mr. Pease. Thank you very much, Mr. Chairman.

I, too, would like to welcome Mr. Fraser to the committee and indicate my very great admiration for you personally and for the United Automobile Workers as an effective representative of its own members, and a union which as much as any union that I know looks after what is good for all workers and all Americans rather than just its own members.

I think your statement today has been eloquent and persuasive, not that I need a lot of persuading, but I think it was eloquent and persuasive, anyhow.

I would like to pursue this business of retaliation. Much has been made of that, and I think you have already commented on it previously.

I have a hard time understanding why anyone would think that there would be retaliation. As you point out, the new bill that came out of the Energy and Commerce Committee does not affect European suppliers. They restrict their markets much more than we do.

I can't understand why they would have any incentive or any grounds to retaliate.

You have pointed out that the Japanese do not retaliate against other countries which have domestic content, and they would still have a very large share of our market.

Can you think of any basis at all for the argument that we are likely to face retaliation if we enact this legislation?

Mr. FRASER. I certainly can't, Congressman, and, frankly, I think in our whole trade relationship with Japan, we have been much too timid. I think that is one of our problems. We haven't been aggressive enough. We haven't been forceful enough. For example, auto industry representatives of Great Britain and Japan met in Acapulco in early 1980. I know the agreement, they had minutes of the meeting and then both sides agreed that the minutes accurately reflected the conversation; that is how they made it.

What they do is that the British auto industry says to the Japanese: You had better make this agreement or else we are going to talk to the Prime Minister, and he will call in the parliamentary leaders and in 1 week we will have a bill. That is how it is done.

As I say, in Canada—I am not advocating this—they just refused to let the Japanese cars out of Vancouver, and they had an agreement within a short time.

We are so timid in our relationship with Japan; we are not forceful enough. Japan plays games with us.

In the recent issue of the "Japan Economic Journal," an editor of that illustrious paper said the Japanese, members of the Diet and their trade representatives, have a technique of easy promises and then slow implementation and procrastination, and I can tell you that describes their trading technique, negotiating technique, to perfection.

Mr. PEASE. In his prepared testimony yesterday, Ambassador Brock said that last year the President's program for assisting the domestic auto industry was announced, and he said that program included reducing excessive regulatory burdens on the auto industry, and then went on to say, "However, the cornerstone of the President's initiative for the auto industry was and remains his economic recovery program."

How much faith do you have in the President's economic recovery program being the cornerstone of the recovery of the auto industry?

Mr. FRASER. God help the autoworkers. You know what is happening. Frankly, I thought we had reached the bottom 6 months ago, but in the last few weeks General Motors and Ford have taken 200,000 cars out of the fourth quarter production. That is how bad they view it.

Just to run back over another figure, we will probably finish this year with sales of 5.8 million cars, or 5.7 million cars, and in 1978, it was 9.4 million. That is how bad off we are. It is not an overstatement to say this is the worst time for the autoworkers and many other Americans since the Great Depression.

Mr. PEASE. I appreciate that comment, and I quite agree with you that lowering of interest rates alone will not solve the problem. Interest rates are part of the problem, but equally as much a problem is the lack of money among consumers to buy cars at any interest rates.

Mr. FRASER. Congressman, if I might, I testified before Congressman Florio's committee on the same subject matter, and preceding me in the testimony was an Assistant Secretary, I believe in the Department of Commerce, by the name of Dederick. He was being questioned by Congresswoman Mikulski. This was March of this year.

He, of course, was opposing the legislation, as is Ambassador Brock, and I understand Secretary Baldrige was here. This individual works for Baldrige. Ms. Mikulski asked, "Well, when do you expect a turnaround?"

He said, "By August at the latest."

She said, "Well, if there is not a turnaround in August, what will you be saying?"

He said, "Well, then we would have to look at our position as relates to this content legislation."

This was in March of this year.

Mr. PEASE. One last question: I was very much interested in and encouraged by your comments on the matter of the comparative quality of U.S. cars and Japanese cars, and the progress that has been made over the last 18 months. It seems to me that there is a perception problem of some sort. I recall several months ago seeing a study, I think out in California, asking people's perceptions, and the perceptions were that American quality was not as good as Japanese quality, and that, of course, coming from an auto producing area, that disturbed me greatly.

Are we going to have to go into a generic advertising campaign of sorts to make the points that you made here today for the buying public?

Mr. FRASER. If you will notice some ads, I haven't seen them, myself; I think the ad campaign started just about a week ago, by the Ford Motor Co., in which they are showing that because of cooperation between the worker on the line and the company, the quality is improving. We are going to have to do a lot of that, but I am afraid the bottom line is, it is going to take a considerable period of time to change that perception.

That is sad, but true, because it has been propagandized so much that we will not be able to turn that perception around by rhetoric.

We are just going to have to prove it, and proving it is going to take a long period of time.

Unfortunately, I believe the American consumer, God bless him, does not pay sufficient attention to safety. That should be a tremendous, quality factor. That one we can prove over and over and over again.

Rust resistance, durability—and I think on the durability argument we have got enough evidence to say it is a fact—that our cars are more durable than the Japanese in the longer run. We can't, I believe, state with authenticity the precise advantage we have, but it is going to take time, and we are just going to have to prove to the American people that we build cars that are equal or better than the Japanese.

Mr. PEASE. Personally, I am convinced that we do, and I just hope we can get that message across.

I conclude just by saying, Mr. Chairman, that I have been interviewed as a cosponsor of this legislation about the CBO study, and others, pointing out the alleged cost to the country and to the consumers in the long run, and my response to that is that if the auto industry does not get help in the short run, there is not going to be any long run for the American auto industry, and that this legislation is justifiable on the ground of protecting what we have and not letting slide into oblivion an important and national resource of this country.

I would like to just commend Mr. Fraser again for his testimony, and to urge him to persevere. We need to win this battle.

Mr. FRASER. Thank you.

Chairman GIBBONS. Mr. Guarini?

Mr. GUARINI. Thank you, Mr. Chairman.

I want to thank you not only for being here, but for your leadership in our country. I think a bill like this is really critical and essential, if we are to protect ourselves.

I don't believe in protectionism, but sometimes it becomes essential, particularly when your trading partners are using very sophisticated devices regarding their trade practices, and from my position on this committee, and from my general knowledge in business, I am very, very convinced that Japan has indulged in very sharp practices, and they have been highly sophisticated.

Unfortunately, our country is weaned on exotic goods, whether it be Italian sweaters or Japanese or German cars, or German beer or other things like that. Our country is capable, with its technology, of producing just as well, if not better.

I agree with you that there is a timidity that we seem to exercise in regard to our deals with our trading partners, and I am fairly convinced that we are too fearful, that instead of dealing from a positive viewpoint, we deal from a negative viewpoint.

I think it is about time that we did something to protect our workers, and I know that there is some conflict of opinion as to the validity of a bill like this, but I want you to know I am very supportive of it in every way.

Every action was taken to try to get a bilateral understanding with Japan, and it has been really a very, very hard go, because I don't think they have been fair or equitable in their dealings with the industries in our country.

I think we can cite a number of instances where we have had very rough going in negotiations with them, when we were trying to put through GATT, and on a number of other subject matters.

Just a query: I am wondering whether or not after we are able to establish our automobile market, and it is critical and essential to our country that we do, will the introduction of the robotics in Japan have a marked effect upon the competition that we will have with them in the future?

I am just wondering whether or not you can address yourself to that, because I know that they are now really going into this in a very substantial way.

Mr. FRASER. Of all of the studies that have taken place, I have seen none that asserts that we are behind Japan technologically in the automobile industry. In other industries I suppose the opposite is true, but in automobiles there is nothing they do that we can't do. They have an advantage because they have newer plants. They have an advantage in that they have more robots than we do, but they are robots that we originally built, and presses that we originally built.

I was in a plant, a Nissan plant which builds Datsuns, about 3 months ago, I spent quite a bit of time in that plant, and it is a good plant, an efficient plant, but I saw nothing there that we don't have. I think in numbers, in sheer numbers of robots, they are ahead of us, but I think we can catch up rather quickly.

But in terms of technological breakthroughs, they have nothing that we don't have.

Mr. **Guarini**. At one time, I remember after World War II we felt that they were great copiers of everything, but they have surprised us, and I think to their credit.

They have certainly been very, very creative and resourceful in their rebuilding of their industries, but I think it is about time America protected itself.

I agree with you wholeheartedly that something has to be done to protect our unemployed and the people of our country.

I thank you very much.

Mr. **Fraser**. Thank you.

Chairman **Gibbons**. Mr. Frenzel?

Mr. **Frenzel**. Thank you, Mr. Chairman.

I want to thank the witness for his testimony. I apologize for putting him through the lunch hour. We are occasionally better behaved, but I am sorry to say not frequently.

I listened and read your testimony with great interest. As you know, I can hardly be classed as one of the great friends of this legislation, but I think your testimony is interesting. It is well prepared.

One of the things about it that bothers me is that you seem to be willing to accept those parts of the CBO analysis that would tend to support your position, but to reject other parts of it.

I have not been able to complete my review of your appendix, but you indicate that there are far more jobs to be gained from this bill than either CBO or the Council of Economic Advisers of the President, or the agency task force that worked on it.

What is there about your analysis that gives you such optimism for the enormous number of job creations which no other agency seems to be able to predict in this case?

Mr. **Fraser**. You will notice in the CBO study, Congressman, they run several scenarios. One which they concede or project is that it would generate 500,000 jobs. Now, where our study departs from the CBO study is the scenario where they say there is going to be retaliation dollar for dollar, which I think is unrealistic. I think everybody on this committee would say it is unrealistic; that is No. 1.

No. 2, they do not project the number of jobs that are going to be outsourced by the domestic companies that we do, and I think those are the two basic differences.

I might say that we think that this bill will create over 700,000 jobs not only for autoworkers but steelworkers, aluminumworkers, rubberworkers, and so forth.

Our methodology of arriving at that figure is open to your scrutiny, or anybody else's. We didn't try to hide it like the Department of Commerce did. We have never even been privy to their methodology.

Mr. **Frenzel**. I thank you. I do notice that the CBO estimate, revised, said that for the total U.S. economy the net effects of the substitute bill in terms of real economic growth, inflation, and employment, would be slightly negative, assuming the U.S. partners retaliate in kind, and that is one of the assumptions that you reject, I take it.

Mr. **Fraser**. If I may, Congressman, one of the sort of astonishing things to me, and I would think you would also share my opinion, CBO's assertion is that the imports will decline even if we don't pass this bill, and I really can't comprehend that assertion.

Mr. **Frenzel**. Yes. I noticed that the Council of Economic Advisers has some different assumptions than the CBO, itself, particularly with respect to Japanese car production in this country, and yet it shows an even sterner result; that is, that this bill will cost America jobs rather than gaining them, and at least that kind of testimony puts you in the difficult position of imposing your salvation on an unwilling country, which is of a little concern to me, because the new jobs that are created, particularly according to the CEA testimony yesterday, is that only 9,000 of them will be in U.S. car production, some 35,000 in Japanese car production and Japanese parts production, and, of course, they won't come on for 2 years.

In the meantime, retaliation is likely to be immediate, so the job costs are likely to occur before these, what I would have to call very minimal job gains.

It seems to me it makes your position exceedingly vulnerable.

Mr. **Fraser**. You know we don't have to theorize here. We can look at the Volkswagen example, and see the tens of thousands of jobs that one assembly plant created for American workers. You can anticipate the same pattern would follow if the Japanese did as Volkswagen did, and so I don't have to theorize or argue about assumptions of the CEA, or CBO, or Commerce Department. We have a model as to what happens.

Mr. **Frenzel**. You do have, and I assure you that we are going to get not only the U.S. car producers in here, but representatives of the foreign companies, and we will see what their intentions are as best they are willing to allow us to know what their intentions are; but certainly we are going to test their reactions against your assumptions and against the assumptions of others, which I think is going to happen.

I will tell you what bothers me, too, about this. Yesterday, Ambassador Brock said that the Japanese imports are up only 200,000 units in the last 5 years, and I assume that is since 1977. Your figures show, you use 1978; it is 300,000. I don't know if you picked a good year or he picked a good year, but, anyway, obviously the problem is that U.S. car sales are way down rather than import sales are way up, and the problem is the recession, I guess, as a number of members have suggested here, and I guess I am part of the problem. I am driving a 12-year-old U.S. car. It has a single virtue.

Mr. **Fraser**. Now I know why we are in a depression.

Mr. **Bailey**. The proof is in the pudding.

Mr. **Frenzel**. It has only got one advantage. It is paid for.

Mr. **Fraser**. It is a pretty good car if you have been driving it for 12 years.

Mr. **Frenzel**. It is a splendid American car.

Mr. **Fraser**. You couldn't drive a Japanese car that long and that far.

Mr. **Frenzel**. You don't know me. I probably would try. My problem here is the number of jobs and the estimates. The jobs may be good for UAW, or the bill may be good for UAW, and it may not be good for America. That is the decision that we are going to have to make.

Mr. **Fraser**. That would trouble me if that were the case.

Mr. **Frenzel**. I was interested in your comments on quality and productivity. I agree with you that we can build good cars here and that we do build good cars here.

I also agree with you that there was a time when our workmanship was not of the best quality, and one of the things that encouraged us to improve our productivity and our quality was the foreign competition——

Mr. **Fraser**. Absolutely.

Mr. **Frenzel** [continuing]. Which this bill is going to largely remove, in my judgment.

Now, I don't want to go back to those old days, and I am sure you don't, and your members don't, either.

How do you get around that?

Mr. **Fraser**. First of all, let me first agree with you that part of our awareness of the quality of the car and the consumer dissatisfaction was the competition. I wouldn't argue that for one moment, but what we are suggesting here would not reduce competition.

We want the Japanese to come here. We want them to build excellent cars. We want them to compete with General Motors and Ford and Chrysler and American Motors. It is precisely what we want.

Mr. **Frenzel**. On page 9 of your testimony, you say, "As a result of nontariff barriers, the U.S. manufacturers couldn't sell very well in Japan."

Yesterday, I suggested, in discussion with one of our witnesses, that they didn't sell very well in Japan because they were not built for the Japanese market nor promoted for the Japanese market. They are the wrong size. The steering wheel is on the wrong side.

The wrong seat is comfortable, and they have to go through the plants, and so on. I don't think it is fair to blame our lack of success in selling cars in Japan wholly to the barriers, and I will agree that there were and still are, I suppose, standard barriers which they think are being at least gradually reduced.

Mr. **Fraser**. There are some nontariff barriers. For example, our cars are tested individually, and in this country, when we test for performance in terms of pollutants or to establish the mileage, the miles per gallon, we take a couple of cars out of a whole fleet. That is a tremendous advantage.

Admittedly, we were building the wrong-size cars for the Japanese roads and Japanese market, but, Congressman, only nine-tenths of 1 percent of the Japanese markets are represented by imports.

Now, that is not only cars from the United States. That is cars from all over the world, from Europe, and certainly they have some attractive small cars.

I have heard this argument a long time about steering wheels on the wrong side. It really doesn't pay to do that unless you get some volume. Otherwise, it is uneconomical. Which comes first, the chicken or the egg? If you had the volume, you could put the steering wheels on the other side. It is no great trick to do that.

Mr. **Frenzel**. Well, sure, but if you aren't willing to invest in some volume over there, you are never going to get it, if you don't turn it around.

Mr. **Fraser**. Unless you anticipate that you are going to get volume, it is not worth the investment.

Mr. **Frenzel**. I would agree.

Mr. **Fraser**. And with the nontariff barriers that they have, we question whether or not we can get the volume. In addition to that, Congressman, and it is a different culture, and I am not even going to be critical of it, but there is a great feeling of nationalism. Maybe it comes from being an island people and a small country, but the Japanese have fierce loyalty to their own products, not basically because of the usual tests of the marketplace, but because for economic reasons they know that they should buy Japanese, and they do that. It is difficult to get into that market.

Mr. **Frenzel**. I agree with you. There is a lot of psychological subconscious by Japanese rattling around in that economy. I just want to comment on a couple of things, and we are going to have to go vote. If you have a response, if we have to leave, you can provide it, I am sure.

One of the things is with respect to your suggestion that the value of the yen is being manipulated. There are a number of people who have suggested that, and if you have any information as to how it is done, we would certainly like to have the specifics on it.

The Europeans are much more assertive in that claim than Americans are, but it has been very hard for us to identify any hanky-panky that we can put our finger on directly.

You also suggested that we ought to do what France and Italy and the United Kingdom do with respect to dealing with Japan.

Of course, they don't sell Japan $2½ billion worth of soybeans, even after we insulted them by turning them off, and I hope you will remember that.

Another statement you made——

Mr. **Fraser**. Of course, I would remark, where are they going to get their soybeans?

Mr. **Frenzel**. They found a way in 1974, I regret to tell you, and they will find a way in the future.

You talked about filing charges at GATT as a means of retaliation. Once we break the GATT rules, which we have been assured this bill does, every other participant in GATT will break the GATT rules back at us, and we will not have to go through the GATT procedures to get retaliated.

You will have a Japanese law on the books of some kind, whether it is soybeans or whether it is less citrus, or what it is.

The worst of it is, however, that other people in the world trading game will come to the same conclusion. The Europeans will say, hey, wait a minute, Americans aren't going to take those cars. They are going to wind up in our third markets, so we are going to bang the Americans, and maybe it isn't soybeans. Maybe it is machine tools; maybe it is corn gluten, but we are going to get it because it happened before, and the only experience we have, which you rejected in your testimony, was the experience of Smoot-Hawley in the thirties.

It was a very bitter experience.

Those are my comments. We are late, but you have got a chance. I will wait around.

Mr. **FRASER**. Certainly we will address the question.

I don't know if we have any suggestions as to how we can manage the distortion of the relationship between the yen and the dollar, but certainly we would be willing to make comments on it.

We are not in agreement as to what would happen in terms of retaliation, because, again, I say, look at what is happening around the world, and look at the auto policies of all the other countries.

Mr. **FRENZEL**. I thank the witness. You are a splendid witness. I appreciate all the testimony, and I am sorry that we are not closer to agreement about the results.

Mr. **FRASER**. Thank you, Congressman.

Chairman **GIBBONS**. Mr. Fraser, I can top Mr. Frenzel. I drive a Chevrolet station wagon. In fact, my wife has it out on the Washington streets right now. It has 142,000 miles on it; it is 14 years old. The other one has only a few thousand miles on it down in Florida. We don't drive it as much. It is all right, although I must say I have had a few problems with it. I must say I can't blame that on you personally.

Mr. **FRASER**. Thank you.

Chairman **GIBBONS**. The committee will stand in recess.

Mr. Fraser, as always, you handled yourself with great distinction. I want to also comment that your Washington staff works hard; they are very effective. We always appreciate their contributions to our legislative process.

Thank you very much. I have got written questions I will submit to you.

Mr. **FRASER**. Thank you very much, Mr. Chairman.

Chairman **GIBBONS**. Senator Riegle, and for all other members, we are going to have to recess until 2 o'clock. We have a very important vote on right now. I hope I will make it.

[Whereupon, at 1 p.m., the subcommittee recessed, to reconvene at 2 p.m. this same day.]

AFTERNOON SESSION

Chairman **GIBBONS**. All right, Mr. Shannon, the time has arrived and we will start.

First, before I recognize you, Mr. Shannon, let me say that I appreciate your being on this committee. You do a fine job. You have got a bright mind, and you apply yourself. I am very appreciative of the work that you have done in the high-technology area, and I hope that as soon as we can get quorum, we can move that particular piece of legislation. I guess the best thing to do is to have you proceed in any manner you want.

STATEMENT OF HON. JAMES M. SHANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. SHANNON. Thank you, Mr. Chairman, and I want to thank you for allowing me to come here today to speak in support of H.R. 5133, the Fair Practices in Automotive Products Act.

I also want to thank you, Mr. Chairman, while I am here, for the accessibility and openness of the subcommittee under your leadership to the trade problems that the various Members of the House and most particularly of the committee are concerned with.

You have always been very expeditious, even in those cases where you might not see eye to eye with some of the members' problems, at least to hold hearings and give everybody a chance to air their concerns.

Like many of my colleagues in this Congress, I have become convinced that it is time for us to take strong action to restore work opportunities for the hundreds of thousands of autoworkers who have been losing their jobs.

It is a well known fact that America's auto industry is in trouble. The Japanese share of car sales in this country has soared since 1978. And, as a result, Americans have paid a heavy price in terms of unemployment and human suffering.

Over the last 4 years, 606,000 auto-related jobs have been lost. It is estimated that unless we act soon, a staggering 42 percent of the remaining auto-related jobs could be gone within the decade, as was pointed out by Mr. Ottinger this morning.

The painful reality of this situation was brought home to me again this month when General Motors announced that it will be laying off 3,400 men and women who work at a plant in my part of Massachusetts, in Framingham, and for every laid-off autoworker, 2.2 other Americans in auto-related industries lose their jobs.

These workers have been victims of forces beyond their control. They have suffered in part because American car makers are increasingly contracting with foreign manufacturers to produce vehicles or parts of vehicles.

Those vehicles end up getting an American label, but what they actually represent are lost American jobs. This practice must stop.

Supporting H.R. 5133 is not a matter of blind protectionism, but it is time we took a good hard look at the practical effects of a trade policy that has allowed an entire industry to begin to rust and crumble.

America has upheld its free trade policy even in the face of increasing foreign regulations, mounting tariff and nontariff barriers, and other anticompetitive practices on the parts of many nations.

Our competitors have, in effect, been telling us, "Sure we'll compete—on your soil."

It would be one thing if these nations had been as open to receiving American-made automobiles as we have been to receiving cars made in their countries.

Yet if someone wanted to buy an American car in Tokyo, the sticker price would be twice what it would be here in the United States.

What sort of free trade policy does that suggest?

The 1982 unemployment figures have convinced many of us that the time has come for creating a new approach toward our foreign auto competitors. A domestic content bill is a reasonable response to a drastic problem.

H.R. 5133 would not institute a policy of blind protectionism. It would not prohibit foreign sales in our markets. Our autoworkers are not asking that Americans purchase only American cars. They are asking only that cars sold in this country have American value added.

By acting on this legislation, we show Japan and other countries that we mean business with respect to our free trade policy. We show that we intend to have a trade policy which does not leave American industry caught in a hammerhold which prevents our workers from competing fairly and squarely for the opportunity to produce cars.

If this legislation is adopted, American consumers could still have the range of product offerings they are looking for. But it would also mean the creation or preservation of hundreds of thousands of jobs. Those jobs are essential, especially at a time when our labor force is being ravaged by the highest unemployment in over 40 years.

The cost of doing nothing has become too great. The cry of the unemployed has become too painful.

And now, we can do something about it—simply by adjusting our trade policies to the realities of the modern world.

I want to commend you, Mr. Chairman, and this committee, for holding these hearings, and I look forward to working with you in the full committee to devise the best strategy for dealing with this critical issue.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Mr. Shannon.

Mr. Shannon, like you, I am very concerned about the competitiveness of America and the problem of jobs. I throw this idea at you cold, and if you would like to respond to it or not, I would like to have you think about it anyway.

One of the things that has worried me is the adversarial nature of the labor/management relationship we have in this country. Some of that is natural and some of it is good, but sometimes we overdo it. I have been trying to think of a way to encourage people to realize that both labor and management have a stake in the outcome of their business and their jobs. It is a two-way street.

I have often thought that it would be a good idea to have greater worker participation in the ownership of the business, of the assets of the business, and I realize that most workers are not in the position to go out and purchase common stock. Some of them do.

I know in Sears Roebuck and similar places some employees have become very wealthy through purchasing common stock, and they have a very fine productive relationship in the company, at least they used to have. I don't know about today.

I was thinking that perhaps on a voluntary basis, either individually voluntary or collectively bargained, you could pay a worker not only in dollars, but also in perhaps common stock.

The common stock would have to be valued at a fair price to reflect the market value of the stock then being traded. The worker could sell the stock immediately and get his cash, or he could retain the stock, hoping that the business would grow, or, if he retained it a year, of course, he could get a capital gain instead of it being taxed at ordinary wage rates.

I guess the only reason that that is not possible now is because if the company pays him in stock rather than in wages, it can't deduct the value of the stock. It would seem to me that with some kind of limitations we could allow them to deduct the value of their stock as if it were cash.

It would have to reflect the market value of the stock. There would have to be some limit on it. It would also have to be voluntary, but it may go some way along to remove this combative nature of management saying: "You are not a part of the business, you are just labor in here," and labor looking at the job and saying, "I am really not a part of the business because I don't really own any of the action. I am just here to get paid."

I would like for you to think about that and I would like to cooperate with you.

Mr. SHANNON. Mr. Chairman, if I could just respond briefly to that, let me say that I wouldn't be here today on this particular issue if I didn't believe that the unions, the United Auto Workers in particular, hadn't taken steps to work more closely with management to deal with a common problem.

I think it is clear that the auto workers have made concessions in the auto industry that are completely unprecedented in American labor history, and I think that that is a good trend.

It shows a willingness to try to change the traditional relationship which has existed.

As to your suggestion that what we should be doing is trying to encourage some employee participation in the ownership of companies, I couldn't agree with you more. We took a step in that direction last year with the tax bill, with the incentive stock option provisions.

Chairman GIBBONS. That is your provision, I recall that.

Mr. SHANNON. We worked on it together. I think we have got to go a lot further. I think that those provisions are useful for newer companies that are trying to capitalize, and using stock options is a way of doing it, but I think employee stock ownership plans are something we should try through the tax laws to encourage, and they could perhaps solve a lot of the kind of labor/management problems that we have had, and I would be very pleased to work with you on that.

Chairman GIBBONS. I will reiterate what you said. I would be very pleased to work with you, Mr. Shannon.

We have the first bell. Soon it will be the second bell on the rule on the continuing resolution, so I think at this point we should take a break and go over and vote.

Thank you very much.

Mr. SHANNON. Thank you, Mr. Chairman.

[Recess.]

Chairman GIBBONS. The hearing will resume.

We welcome the witnesses from the American Federation of Labor and the CIO. Mr. Denison, you may proceed as you wish.

STATEMENT OF RAY DENISON, DIRECTOR, DEPARTMENT OF LEGISLATION, ACCOMPANIED BY ELIZABETH JAGER, ECONOMIST, DEPARTMENT OF ECONOMIC RESEARCH, AND STEPHEN KOPLAN, LEGISLATIVE REPRESENTATIVE, DEPARTMENT OF LEGISLATION, AFL-CIO

Mr. DENISON. Thank you. I am accompanied today by Elizabeth Jager, an economist with the AFL-CIO Department of Economic Research, and Stephen Koplan, legislative representative from the federation.

I won't attempt to read my entire statement. I will ask that it be printed in the record.

I will make some comments from it and then some remarks concerning earlier testimony.

Chairman GIBBONS. Certainly. Your entire statement will be made a part of the record at this point.

Mr. DENISON. The AFL-CIO welcomes this opportunity to support H.R. 5133, the Fair Practices in Automotive Products Act.

This proposal was introduced last December by Representative Richard Ottinger and has been cosponsored by 224 Members of the House, from both sides of the aisle.

Gentlemen, many times in the past the AFL-CIO has come before this committee asking for congressional help to save American industries and jobs. Too often the responses have been too little or too late or not at all, and year after year the strong, broad-based industrial machine that was America has been weakened and its workers displaced, not because these industries have become obsolete but because these industries have been overwhelmed by foreign trade practices.

Now we face an emergency situation involving an industry that is basic to our economy and whose fate could decide whether this Nation will regain its productive health or slide into a depression.

In each previous postwar recession, the lead of the auto and the housing sector have been keys to the overall economy and recovery.

Therefore, to us, this legislation is of the greatest importance.

The AFL-CIO represents 14.5 million workers who are important to our society as breadwinners, consumers, and taxpayers. Many of these members are in the automotive industry, directly, or indirectly, and their jobs are threatened by the massive imports of foreign-made automobiles, trucks, and parts. Already tens of thousand have lost their jobs in rubber, steel, aluminum, glass, textiles, paper, electronics, and plastics, as well as directly in the auto industry, because of this threat.

More than 1 million auto jobs have been affected by imports and the number is rising sharply. The ripple effect is having a smothering effect on the U.S. economy where one out of every six jobs is related to the auto industry.

Since December of 1978, more than 344,000 workers in the auto industry sector classified as motor vehicles and equipment have lost their jobs. Between June 1981 and June 1982, employment fell by 113,000. During that same period, 213,000 jobs disappeared in the primary metal industry, 117,000 at car dealerships, 34,000 in the automatic stamping industry, and 24,000 in the tires and inner-tube industry.

Many additional workers lost their jobs in various industrial groups that supply the auto industry, but whose job loss is not separately identifiable from the general employment data.

The impact extends to all regions of the country and the total community in which affected workers once worked. Many are no longer taxpayers, but now are unemployment compensation beneficiaries and soon welfare recipients. This loss is a massive national toll as a financial burden on society, a tax loss to the community, a loss of our industrial base, our defense-related capability, and a rising trade deficit.

At the AFL-CIO Convention in New York last November, the delegates adopted a policy resolution on international trade and investment which stated in pertinent part:

> Domestic content laws should be enacted to assure continued production of such products as autos. A U.S. production requirement is needed to preserve employment and skills and shore up the nation's sagging industrial base. Local content requirements in autos should be tied to sales volume and should be phased in beginning with the 1983 model year.

H.R. 5133 provides a strong response to the critical need for domestic content laws to reestablish a viable U.S. automobile industry. It is based on the concept that multinational auto companies—United States, French, German, or Japanese—should provide the United States with jobs and production, not just assembly jobs, when they enjoy the advantages of the U.S. market.

The proposal simply extends current U.S. domestic content requirement laws so that passenger cars and light trucks will be required to have a gradually rising percentage standard of American-produced parts.

Other nations have combinations of domestic content laws or policies, high tariffs, quotas and/or embargoes, subsidies, and requirements for auto exports, plus in some cases export requirements for parts.

Most countries have much higher requirements in law and/or in practices than the United States. The attached tables, appendix I, submitted to the International Trade Commission by the United Auto Workers gives a sense of the extent of this practice.

The American autoworker is just as productive as the Japanese autoworker, according to a recent study of the Japanese Productivity Council. Some adversaries of this bill argue that this bill would be inflationary, but they ignore the inflationary thrust that would exist if we were totally dependent upon foreign producers. Nor do they deal with the 20-percent decline in the value of the yen during the last 10 months, resulting from high U.S. interest rates.

The result of passage of this bill would be that the changing technology of the auto industry could be absorbed. The rapidly escalating outrush of production would not lead to a complete destruction of this important American industry. Instead, H.R. 5133 creates an opportunity for manufacturers from all nations to sell and produce cars here, employing U.S. labor and providing a multiplier effect on production and jobs in services in this economy.

This will benefit U.S. consumers who wish to continue to choose among a variety of cars, U.S. workers whose jobs consist of parts and assembly operations for motor vehicles, and for U.S. business which has a major stake in participating in the expansion, rather than the decimation of the American auto industry.

I would just like to add, Mr. Chairman, that some response is in order, we feel, in reference to testimony given yesterday by various administration witnesses, and, because of the shrillness of some of the testimony given, we felt it important that the record reflect at least our response to those charges.

The administration claims that the bill will increase the price of an automobile by $1,000, and Ambassador Brock said that his personal view was that it could raise the price of a car $1,500, which was not supported by any documentation.

This estimate of $1,000 evidently is based on an earlier Council of Economic Advisers model which has unrealistic assumptions, such as the closing off of the auto market.

The experience in Europe where there are high trade barriers has been that car prices have recently fallen because there is strong price competition going on there.

This bill can add to, we feel, and not decrease competition and car prices can be contained.

The administration claims in testimony yesterday that Honda and Nissan could not comply with the requirements of the bill, and Ambassador Brock said he is not sure that American companies could comply.

Our response to that is that the Japanese have complied with Australian, Mexican, and other requirements that are more complex than the proposed U.S. content law, and American companies certainly could comply with such an arrangement as they have done all over the world.

The assertion was also made yesterday that there is no way that the bill will encourage foreign investment here. Our response is that such laws have encouraged investment everywhere else, where they are in effect.

Companies have been investing in Mexico since the 1977 decree by that Government. The Japanese were expanding in Britain and Italy when those countries were adding trade barriers in the last few years, but they have not expanded in the United States to that degree where virtually no trade barriers exist on automobiles.

The assertion was made that the bill is protectionist and will effectively insulate the auto industry from competition. Our response is, this bill will merely assure more domestic competition because there will be competition within the U.S. market and we will not be subjected to competition coming solely from the outside when our own producers become weakened and atrophied.

The administration claimed that the Japanese will sell only luxury cars if the bill is passed, and our response is the Japanese will meet market demand as business people normally do.

They will sell what U.S. buyers and U.S. laws will require.

Secretary Baldrige claimed that the Department of Transportation counts a loss of 12,000 direct jobs in ports if the bill passes, and our response to that is this assumes that dockworkers can only unload automobiles.

Dockworkers' jobs could be increased if as many as 1 million U.S. autoworkers could buy products because they were not out of work and had the money to spend on such products as the dockworkers would be unloading from abroad.

Secretary Baldrige claims that consumer choice will be gone, and that prices will rise. Our response is the consumer will have the choice to buy American-made cars whether they be General Motors, Toyota, Ford, Datsun, Chrysler, and not lose that option as the consumer has lost it in so many other industries.

Prices have not risen in industries where trade barriers have applied to the degree that they have in industries where they have not. The color TV barriers were supposed to stop price curtailment. They have not. This bill does not stop imports. It merely assures more competition in the U.S. market.

Let me just conclude, Mr. Chairman, by saying that we feel that apart from the testimony that has been given here this morning, there is another danger if this legislation is not reported favorably by the committee, and acted upon by the Congress, and that is that it is our fear that there will be a great outpouring of hostility among American workers because we have learned, the AFL-CIO that is, in recent meetings throughout the country, that if there was one piece of legislation that generated their interest and brought them to their feet, if you will, it was the matter of content legislation.

We talked to American workers about a whole list of legislative matters, and the content issue brought the greatest response. My fear, Mr. Chairman, is that if there is no action on this, there will be tremendous disappointment and a reaction that something even more restrictive might be called for.

What was particularly disturbing is while we were in Michigan at the meetings there, and we had meetings in Texas, Seattle, Birmingham, Louisville, and throughout the country, we noticed particularly in the middle west the bumper stickers and the statements made that make one pause.

One bumper sticker, for example, said, "If you are hungry, eat your Toyota." It is that kind of rising resentment that is beginning to be evidenced in the countryside that we are concerned about, and we think a rational legislative response is in order, and we believe that the content bill is that rational response.

Thank you.

[The prepared statement and additional material follow:]

STATEMENT OF RAY DENISON, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

The AFL-CIO welcomes this opportunity to support H.R. 5133, the Fair Practices in Automotive Products Act. This proposal was introduced last December by Representative Richard Ottinger and has been cosponsored by 224 members of the House—from both sides of the aisle.

Gentlemen, many times in the past the AFL-CIO has come before this committee asking for Congressional help to save American industries and jobs. Too often the responses have been too little or too late or not at all, and year after year the strong, broadbased industrial machine that was America has been weakened and its workers displaced, not because these industries have become obsolete but because these industries have been overwhelmed by foreign trade practices.

Now we face an emergency situation involving an industry that is basic to our economy and whose fate could decide whether this nation will regain its productive health or slide into a depression. In each previous post-war recession, the lead of the auto and the housing sector have been keys to the overall economy. Therefore, to us, this legislation is of the greatest importance. The AFL-CIO represents 14½ million workers who are important to our society as breadwinners, consumers and taxpayers. Many of these members are in the automotive industry, directly or indirectly and their jobs are threatened by the massive imports of foreign-made automobiles, trucks and parts. Already tens of thousands have lost their jobs in rubber, steel, aluminum, glass, textiles, paper, electronics and plastics—as well as directly in the auto industry—because of this threat.

More than one million auto jobs have been affected by imports and the number is rising sharply, and the ripple effect is having a smothering effect on the U.S. economy where one out of every six jobs is related to the auto industry.

Since December 7, 1978 more than 344,000 workers in the auto industry sector classified as motor vehicles and equipment (SIC 371) have lost their jobs. Between June 1981 and June 1982, employment fell by 113,000. During that same period, 213,000 jobs disappeared in the primary metal industry, 117,000 at car dealerships, 34,000 in the automatic stamping industry and 24,000 in the tires and inner tube industry. Many additional workers lost their jobs in various groups that supply the auto industry, but whose job loss is not separately identifiable from the general employment data.

The impact extends to all regions of the country and the total community in which affected workers once worked. Many are no longer taxpayers, but now are unemployment compensation beneficiaries and soon welfare recipients. This loss is a massive national toll as a financial burden on society, a tax-loss to the community, a loss of our industrial base, our defense-related capability and a rising trade deficit.

At the AFL-CIO Convention in New York last November, the delegates adopted a policy resolution on International Trade and Investment which stated in pertinent part: Domestic content laws should be enacted to assure continued production of such products as autos. A U.S. production requirement is needed to preserve employment and skills and shore up the nation's sagging industrial base. Local content requirements in autos should be tied to sale volume and should be phased in beginning with the 1982 model year.

H.R. 5133 provides a strong response to the critical need for domestic content laws to reestablish a viable U.S. automobile industry. It is based on the concept that multinational auto companies—U.S., French, German or Japanese—should provide the United States with jobs and production—not just assembly jobs—when they enjoy the advantages of the U.S. market. The proposal simply extends current U.S. domestic content requirement laws so that passenger cars and light trucks will be required to have a gradually rising percentage standard of American-produced parts.

Domestic content is not a new idea. For example, the U.S. has had domestic content provisions in the Energy Policy and Conservation Act of 1975 (a 75 percent domestic requirement for an automobile to qualify as domestically manufactured for purposes of determining average fuel economy).

Many of the countries such as Australia, Brazil, Mexico, South Korea and Spain have domestic content requirements. This specter of foreign retaliation is often raised as an objection to U.S. auto content legislation. But there has been no retaliation in the cases of the above listed countries.

As the Japanese currently are targeting the aerospace industry for future development, All Nippon Airway in its purchase orders for new planes is reportedly requesting a certain percentage of the content be of Japanese origin. The U.S. has not retaliated against this action.

Other nations have combinations of domestic content laws or policies, high tariffs, quotas and/or embargoes, subsidies, and requirements for auto exports—plus in some cases, export requirements for parts.

Most countries have much higher requirements in law and/or in practices than the U.S. The attached tables (Appendix A) submitted to the International Trade Commission by the United Auto Workers gives a sense of the extent of this practice. What the tables do not show, however, is that there has also been an effective de facto content requirement in Western Europe that creates an enormous advantage for producing there. Between members of the European Community and members of the European Free Trade Association—that is in most Western Europe—there has been a duty-free transfer privilege for production within their borders, but a tariff on parts and cars from the outside—tariffs that are generally higher than those of the United States. The effect encourages production in Europe. Many European countries also have quotas in "gentlemen's" agreements or other regulations to keep out a flood of car imports—particularly in France and Italy, and more recently in Great Britain.

Relatively speaking, therefore, the United States has virtually no tariff and non-tariff barriers on autos and parts in comparison to those of other countries. The Japanese, for example, have no tariff, but they have a high commodity tax (which they raised in April 1981), a national distribution system that stands in the way of imports, and an inspection system that means that every car entering Japan may be individually inspected.

The result is that Japanese cars sell for less in the U.S. than they do in Japan, whereas U.S. cars sell for two to three times their U.S. selling price in Japan.

The U.S. has a 2.8 percent tariff and the rest of the world has tariffs from 7.6 percent of 205 percent (see Appendix B). Under these circumstances, the incentive to produce abroad and flood the U.S. market is escalating.

Meantime, U.S. and foreign auto companies have become multinationals. They will continue to foreign source their parts. H.R. 5133 does not stop all foreign sourcing. But the bill does limit the percentage of content that a company can foreign source to stem the outrush of parts production from the United States.

Foreign sourcing already accounts for a great deal of U.S. auto manufacturer's purchases. The attached list of major components sourced between 1977 and 1981 (Appendix C) demonstrates how serious this problem has become. Without H.R. 5133, the bleak future for America's industry will have to have more and more parts production moved abroad and to make the U.S. a mere assembler of foreign-made parts. Unless that trend is reversed, drastic reduction in U.S. auto jobs and production will continue and ultimately cost the nation its security as well as its technological future.

The provisions of the bill are designed to find a middle way—to assure a viable industry here, without stopping all multinational integration.

The content formula, therefore, is based on costs of the U.S. automotive production for which a company is responsible as a percent of U.S. automotive sales. "Content" means the total U.S. cost of a manufacturing company's production at wholesale factory prices to dealers for all cars and light trucks sold in a year. Both parts made by the company and parts purchased from other U.S. producers would be given credit as domestic value. Automotive exports count, along with the production sold in the U.S.

The bill sets a ratio of content, depending upon the level of cars the company sells in the U.S. It is phased in gradually, beginning in model year 1984. By model year 1986, if a multinational company sells 100,001 vehicles in the U.S., it would have to produce or buy domestic production worth 10 percent of its auto sales here; 150,000, 15 percent; 200,000, 20 percent; and 500,000, 50 percent, and 900,000, 90 percent. The bill provides that starting at sales above 100,000 a company divides its sales by 10,000, and that number is the resultant domestic content requirement up to a maximum of 90 percent.

The Secretary of Transportation is directed to study and report to Congress within a year on policy and practices of foreign auto manufacturers that influence U.S. dealers to favor foreign-made parts. The Secretary is to recommend administrative or legislative action that would assure domestic producers of replacement fair access to the U.S. market for such parts.

The bill also instructs the Secretary of Transportation to issue necessary regulations, monitor compliance and issue annual reports on local content. Penalties for failing to reach the content level would lead to a curb in allowable imports in the following year.

The American auto worker is just as productive as the Japanese auto worker, according to a recent study of the Japanese Productivity Council. Some adversaries of this bill argue that this bill would be inflationary. But they ignore the inflationary thrust that would exist if we were totally dependent upon foreign producers, nor do they deal with the 20 percent decline in the value of the yen during the last 20 months, resulting from high U.S. interest rates.

The result of passage of this bill would be that the changing technology of the auto industry could be absorbed. The rapidly escalating outrush of production would not lead to a complete destruction of this important American industry. Instead, H.R. 5133 creates an opportunity for manufacturers from all nations to sell and produce cars here, employing U.S. labor and providing a multiplier effect on production and jobs in services in this economy.

This will benefit U.S. consumers who wish to continue to choose among a variety of cars, U.S. workers whose jobs consist of parts and assembly operations for motor vehicles, and for U.S. business which has a major stake in participating in the expansion, rather than the decimation of the American auto industry.

For these reasons, the AFL-CIO endorses H.R. 5133, a fair bill designed to take automobiles and related parts off the list of endangered U.S. industries. Its passage is bound to have a positive ripple effect on the U.S. economy.

Attachment.

APPENDIX I—SURVEY OF AUTOMOTIVE TRADE RESTRICTIONS MAINTAINED BY SELECTED NATIONS

Compiled by the Office of International Sectoral Policy, U.S. Department of Commerce from information supplied by U.S. Embassies, Commerce country analysts, and industry sources. The accuracy of the information received has not been verified.

Summary of Foreign Automobile Trade Restrictions 1/

Country	Local Content Requirements	Import Restrictions 2/	Export Requirements	Operations	
				Japanese	United States
Algeria	No	Yes	No		
Argentina	Yes	Yes	Yes	Yes	Yes
Australia	Yes	Yes	No	Yes	Yes
Austria	No	Yes	No		Yes
Belgium	No	Yes	No		Yes
Bolivia	Yes	Yes	No		
Brazil	Yes	Yes	Yes	Yes	Yes
Chile	Yes	Yes	Yes		Yes
Colombia	Yes	Yes	Yes		Yes
Denmark	No	No	No		
Ecuador	No	Yes	No		Yes
Egypt	Yes	Yes	No		
France	No	Yes	No		
Germany	No	No	No		Yes
Ghana	No	Yes	No		Yes
Greece	Yes	Yes	No	Yes	
India	Yes	Yes	No		
Indonesia	Yes	Yes	No	Yes	Yes
Israel	No	Yes	No		Yes
Italy	No	Yes	No		
Japan	No	No	No		Yes
Kenya	No	Yes	Yes	Yes	Yes
Kuwait	No	No	No		
Malaysia	Yes	Yes	NA		
Mexico	Yes	Yes	Yes	Yes	Yes
Morocco	Yes	Yes	No		Yes
Netherlands	No	No	No		
New Zealand	No	Yes	No	Yes	Yes
Nigeria	Yes	Yes	No		
Norway	No	Yes	No		
Pakistan	Yes	Yes	Yes		Yes
Peru	Yes	Yes	No	Yes	Yes
Philippines	Yes	Yes	Yes	Yes	Yes
Portugal	Yes	Yes	No	Yes	Yes
Saudi Arabia	No	No	No		
Singapore	No	Yes	No	Yes	Yes
South Africa	Yes	Yes	No	Yes	Yes
South Korea	Yes	Yes	Yes		
Spain	Yes	Yes	No		
Sweden	No	No	No		
Switzerland	No	No	No		
Taiwan	Yes	Yes	No		
Tanzania	No	Yes	No		
Thailand	Yes	Yes	No	Yes	Yes
Turkey	Yes	Yes	Yes		Yes
United Kingdom	No	Yes	No		Yes
Uruguay	Yes	Yes	Yes		Yes
Venezuela	Yes	Yes	Yes	Yes	Yes
Yugoslavia	Yes	Yes	No		

1/ The measures cited in this chart are for new cars. Trade restrictions on used cars are not reflected.

2/ Import restrictions apply to non-tariff measures maintained by a country which deal solely with imports. Tax measures which apply to both imports and domestically produced products are not included.

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Industrialized Countries Surveyed

Australia: A local content requirement of 85 percent is in effect. However, under the Export Facilitation Scheme, due to commence on March 1, 1982, Australian car manufacturers would be allowed to credit exports against local content requirements. These credits will increase from 5 percent in 1982 to 6.25 percent in 1983 and 7.5 percent in 1984 and can be used to import components duty free. The effect would be to reduce the local content requirement to 75 percent by 1984. Australia maintains a quota limiting imports of assembled vehicles to 20 percent of the existing market. There are import tariffs of 35-57.2 percent depending on stage of assembly. No export incentives exist. General Motors, Ford, Chrysler, Toyota and Nissan produce vehicles in Australia.

Austria: No local content regulations or export requirements are in effect in Austria. The automobile import duty is 20 percent. The value added tax (VAT) on automobiles is 30 percent. Steyr-Daimler-Puch (S-D-P) produces mopeds, trucks, busses and tractors. General Motors will shortly begin production of automobile engines and transmissions. S-D-P and BMW will soon produce diesel automobile engines.

Belgium: No local content regulations or export requirements are maintained by Belgium. There are reportedly quantitative restrictions on imports from Japan, Taiwan, South Korea, Indochina, and Eastern European countries. The import tariff on automobiles is the EC's 10.9 percent common external tariff. A 25 percent value added tax is levied on all automobiles sold in Belgium. Ford, GM, British Leyland, Peugeot-Citroen, and Volvo assemble cars and trucks, while Renault and Volkswagen assemble only automobiles in Belgium.

Canada: U.S.-Canadian auto trade is conducted under the terms of the Automotive Parts Trade Agreement (APTA). This trade is duty free. Canada has a 14.2 percent import duty on imports of non-U.S. cars and trucks and has safety and emission requirements similar to the United States. There are no local content requirements or quantitative restrictions. Chrysler, GM, Ford, AMC and Volvo have manufacturing facilities in Canada.

Denmark: There are no restrictions on automobile imports except the 10.9 percent EC common external tariff. A 20.25 percent VAT is levied.

France: There are no local content regulations or export requirements. Imports of Japanese automobiles have never risen to over 3 percent of the market and the French government has announced that it does not want them to exceed this level. The EC's 10.9 percent automobile tariff applies. There is a 33.3 percent VAT. General Motors and Ford produce components in France.

Germany: There are no local content, export requirements, or quantitative limitations. Germany applies the EC's 10.9 percent common external tariff on automobiles and has a 13 percent VAT. Germany maintains rigid safety and emissions standards. In addition, there is a graduated motor vehicle tax based on horsepower. General Motors and Ford have manufacturing/assembly plants.

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Italy: No local content regulations or export requirements exist. Italy applies the EC's 10.9 percent common external tariff on automobiles. Italy has formal quantitative restrictions on vehicle imports from certain Far Eastern (1980 allotment from Japan is 2,200 cars) and Eastern European countries. In addition, Italy's strict safety standards make certification of imported automobiles difficult to obtain. The automobile import duty is 10.9 percent. A VAT varying from 18-35 percent depending on engine size is applicable to all automobile sales.

Japan: Japan maintains no local content requirements or quantitative restrictions or import duties on automobiles. There is a 15 or 20 percent commodity tax levied on automobiles depending on engine size and on overall auto dimensions, and an annual automobile tax which also increases by engine size. The mechanical safety and environmental modifications required to comply with Japanese stringent vehicle regulations have discouraged imports. Additional disadvantages to American automobiles include the higher dealer margins and a complicated multi-layered distribution system.

Netherlands: The Dutch vehicle manufacturing industry is relatively small. DAF a Dutch firm, manufactures commercial and military vehicles. Volvo produces passenger cars and there are a number of smaller Dutch bus and trailer manufacturers. The tariff on automobiles is 10.9 percent for imports of automobiles from the U.S. into the EEC. There is an 18 percent value-added tax. Additionally, manufacturers or importers of passenger cars have to pay a special consumption tax of 16 or 17 percent. Imports are not subject to any special import licenses or quantitative restrictions.

New Zealand: There are no specific regulations dictating the amount of local content in automobiles assembled in this country. However, an import licensing system mandates the use of local components. Tariffs for completely built up autos (CBU) are: 55 percent for general tariff; 20 percent for Australia and the U.K.; and 33.3 percent to 55 percent for Canada depending on the level of commonwealth country content. Import tariffs for completely knocked down (CKD) units are: 45 percent general tariff rate; preferential rates of 6.25 percent for Australia and the U.K., and 17.75 percent to 45 percent for Canada depending on the level of Commonwealth country content. Certain Australian CKD autos are duty free and certain CBU autos are subject to a 10 percent duty under terms of the New Zealand Australian Free Trade Associaion. Licenses are required to import CKD cars but are, in effect, obtained automatically by assemblers. Licenses for CBU units are strictly controlled and currently maintained at a level of approximately 4 to 5 percent of the total annual sales of 65,000 to 70,000 units. Ford, General Motors, Chrysler, Toyota, British Leyland, Honda, Mazda, Skoda, Subaru, Datsun, Mitsubishi, and Talbot (Peugeot) have local assembly plants.

Norway: There are no local content regulations or vehicle import restrictions. Automobile import tariffs are 7.5 percent with an additional vehicle tax varying from 68-153 percent of the vehicle value. There is no automobile production in Norway.

Spain: Local content requirement for vehicles assembled in Spain is 55 percent. There are no import quotas. The import tariff for non-EC/EFTA source vehicles is 68 percent with a compensatory import tax of 13 percent. Luxury tax varies between 17.6-35 percent depending on horsepower of vehicle. Fiat, Renault, Citroen, Peugeot, Ford, General Motors have assembly operations in Spain.

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Sweden: There are no local content regulations. There is a 9 percent CIF import tariff on passenger cars and a 20.63 percent VAT on the duty paid value. There are apparently nonrestrictive import licenses, as well as stringent safety and emission standards. Swedish producers receive a rebate of all duties paid on imported components incorporated in a car which is exported. Only Saab and Volvo manufacture in Sweden.

Switzerland: Tariffs on passenger vehicles imported into Switzerland from the U.S. range from Swiss Francs 79.62 to 134.50 per 100 kilograms gross. Swiss impose duties on weight rather than on value. Substantially lower tariffs have been accorded to EC and EFTA suppliers. In addition, a turnover tax of 8.4 percent *ad valorem* is levied. No quantitative import restrictions are maintained; however, at time of registration of an imported vehicle in Switzerland the U.S. made product must conform with the Swiss Regulations on Construction and Equipment of Motor Vehicles, amendments to which became effective on January 1, 1980. The objectives of the amendments are to reduce gradually noise level limits by October 1, 1982 and 1986, respectively. Swiss-made trucks and jeeps are manufactured and assembled at Arbon in the Canton of Thurgau.

United Kingdom: There are no local content regulations or export requirements. The import tariff on automobiles is the EC's common external tariff of 10.9 percent. It has been publicly reported that imports from Japan are voluntarily limited by the Japanese manufacturers to approximately 10 percent of the market. British Leyland, Ford, GM, and Peugeot-Citroen manufacture in the U.K. In addition there are numerous small, specialty firms. Current plans are for British Leyland to manufacture Honda designed automobiles in the near future.

Developing Countries Surveyed

The Andean Pact's Automotive Program

In 1977 the five Andean Pact members (Bolivia, Colombia, Ecuador, Peru, Venezuela) signed an agreement calling for the production of vehicles based on local componentry, with local content eventually reaching 70 percent. According to the Pact's schedule, the program will be in effect by the end of 1983. However, due to disagreements by Pact members as to who would produce certain types of vehicles and, even more importantly, key components such as engines, progress in implementing the program has been slow.

A Common External Tariff is to give protection against non-pact vehicles, 115 percent in the case of passenger cars similar to those to be produced in the Andean region and 155 percent for cars other than those produced there.

The following companies have signed agreements to participate in the program: General Motors, Volkswagen, and Fiat; other companies that are considering participating are: Ford, Renault, Mack Trucks, Nissan, Pegaso, and Volvo. In addition to these general provisions, member countries have the following specific rules:

Bolivia: There are no vehicle manufacturing or assembly operations in Bolivia.

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Colombia: A 33 percent local content regulation is maintained on firms which assemble automobiles from imported components. Imported automobiles are assessed a 150 percent duty, a 35 percent sales tax, a 5 percent export promotion fee, a 1.5 percent export diversification fund tax, and a 1 percent consular invoice fee. There are no quantitative restrictions, but import licenses are used to restrict imports. Renault produces passenger cars. GM produces automobiles, trucks and van chassis. Fiat produces cars, trucks and buses.

Ecuador: There are presently no local content restrictions or export requirements in Ecuador. Import duties on automobiles range from 100 percent to 190 percent depending on price; on trucks and vans duties are 80 percent or 100 percent depending on type and capacity; and on four wheel drive vehicles they are 60 percent or 70 percent depending on price. In addition, an import surcharge of 10 percent on the c.i.f. value is applied to all motor vehicle imports except trucks. On all items, importation requirements call for a 1 percent service charge and a 50 percent prior deposit, both on the c.i.f. value. Importers are required to prepay 80 percent of the import duties before the import license is received. This license is issued by the Ministry of Industries, Commerce and Integration. In addition to the overall quota, each automotive dealer or distributor is assigned an individual quota. This is computed on the basis of past imports, and therefore, it varies for each distributor/dealer. Newly established dealers are assigned a quota of $40,000 per each six months.

Ecuador has begun to implement its ANCOM (Andean Common Market) assigned rights to manufacture: (1) light passenger cars and engines of 1050-1500 cc. motor size, and (2) light trucks and transmissions of 3.0-4.6 metric tons capacity. The Ecuadorean Government and Volkswagen signed a contract in December 1978 for the production of a passenger car. General Motors is carrying out feasibility studies for the production of light trucks.

Peru: Local content regulations require 10-35 percent local content depending on vehicle type. Although built up vehicle imports have been prohibited to date, reports are that import licenses will be obtainable in 1980. Import tariffs are 40 percent on trucks and 155 percent on automobiles. There is a 14.4 percent manufacturers tax. Exports are encouraged by rebating the import duties paid on imported components in the exported vehicle. Chrysler, Volkswagen, and Nissan assemble cars and trucks. Toyota assembles cars and Volvo assembles trucks.

Venezuela: Local content regulations call for annual increases from 48 percent currently to 90 percent in 1985. Imports are restricted to vehicle types produced locally. The tariff on imports is 120 percent on Venezuelan Government reference price. Export requirements are based on a percent of the value of national automobile production and in some instances they are quantitative requirements written into the assembler's contract. In addition to three local firms, Renault and Volkswagen assemble cars; Fiat, GM, and Ford assemble cars and trucks; Mack and International assemble trucks; and AMC and Toyota assemble jeeps.

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According to press reports, the Venezuelan Economic Cabinet approved a new automobile import policy on April 24, 1980. Now prohibited is the importation of 8-cylinder models (except by the government). All other models not produced in the country could be imported without license upon payment of ad valorem duty of 170 percent and a specific duty of 100 Bolivars per kilo. Models similar to those produced in Venezuela would pay an ad valorem duty of 120 percent only. Vans and 9-11 passenger vehicles would pay 135 percent ad valorem and 100 Bolivars per kilogram specific duties. Effective date of this new measure will presumably depend on publication of corresponding decree in the official gazette with new list of reference prices for 1980. Last year this took place on June 1st.

Other Developing Countries

Algeria: There are no automobile manufacturing assembly operations in Algeria. Unspecified quantitative restrictions on automobiles are in effect. Import duties on automobiles range from 40-50 percent.

Argentina: Local content regulations exist for all vehicles as follows: passenger - 93 percent in 1980, reduced to 88 percent in 1982; commercial - from 93-90 percent in 1980, reduced to 75-88 percent in 1982. Import tariffs on vehicles are 95 percent on cars (declining to 55 percent in 1982) and 65 percent on trucks (declining to 45 percent in 1982). Minimum import prices are $4 per cubic centimeter engine displacement plus 19 percent freight on cars. Export requirements apply only to intercompany parts shipments. Under this requirement exports must be 1 times the import level. Ford, Volkswagen, Fiat-Peugeot, Mercedes-Benz, and Saab have manufacturing facilities in Argentina.

Brazil: Local content regulations are in effect but are now individually negotiated with each firm with factors such as the individual firms balance of payments being taken into account.

Export incentives in the form of reduced import tariffs on parts are granted (under GATT these are being phased out). Imports of automobiles are currently embargoed. Normally, import tariffs on passenger cars are from 185 percent to 205 percent. In addition there is a system of minimum import values based on the car's weight. Passenger cars are produced in Brazil by Ford, GM, Volkswagen, Toyota, Puma and Fiat. Trucks are manufactured by Ford, Chrysler, GM, Mercedes, Fiat, Saab, Volvo, and Toyota.

Chile: Local content regulations requiring 30 percent of assembled cost for automobile manufacturers are in force. Exports are not required unless local content is less than 30 percent. In this case the local assemblers must export sufficient products to reach 30 percent of local production costs. Import tariffs on automobiles range from 10-80 percent depending on engine displacement. The 80 percent tariff will be reduced each year to reach a final rate of 10 percent in 1986. There is a 100 percent consumption tax if an automobile's CIF value plus duty, plus a 20 percent VAT exceeds $12,000. This consumption tax only applies to the amount over $12,000. There are no quantitative restrictions. GM assembles automobiles and trucks. Citroen, Fiat and Peugeot-Renault assemble automobiles.

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Egypt: Local content regulations vary by contract with each assembler. Fiat has a joint venture for automobiles with 30 percent to 40 percent local content required and AMC jeeps are assembled with a 15-20 percent local content. There are no export requirements. Import duties vary from 85 percent to 300 percent depending on engine size and number of cylinders. Individuals are allowed to import only one car every two years and the importation of right hand drive cars is forbidden. Payment of import duties must be made in hard currency.

Ghana: There are no local content regulations or export requirements in Ghana. A purchase tax which varies from 5 percent to 100 percent based on the car's value encourages local production. Commercial vehicles assembled in Ghana do not pay this tax. Under the vehicle standardization policy in effect since October 3, 1979, only vehicles - passenger cars, pick-ups, cross country vehicles, and buses - manufactured by approved manufacturers may be imported. The list includes Peugeot, Datsun, Volkswagen, Renault, Mazda, and Mack Truck. Cars for diplomats and Ghanaian officials are exempt from this requirement. Renault and Toyo Kogyo assemble cars. Nissan, Toyota, and Vauxhall assemble cars and buses. British Leyland, Ford, and Mercedes-Benz assemble buses and trucks. Chrysler, Deutz, Hino, M.A.N., and Mack assemble trucks. Neoplan assembles buses. Import tariffs range from 15 to 35 percent.

Greece: The value added component requirement imposed on local motor vehicle assembly is a minimum of 25 percent without mandatory upward escalation. Tariffs on imports from non-EEC countries range from 10 to 20.7 percent. In November 1979, a voluntary system designed to restrain imports was adopted providing for a reduction of 20 percent in car imports. Bus imports require an import license. The issuance of licenses is, at times, delayed or withheld. A pre-import cash deposit of 56 percent for buses and 28 percent for passenger automobiles is also required. The deposits are retained by the government for two months.

India: Local content regulations exist only for the domestic Indian automobile producers. There is no investment by foreign automobile manufacturers. Exports are encouraged by cash subsidies and import replenishment licenses. Import tariffs on other vehicles vary from 100-140 percent depending on type and axle weight. Import licenses are generally not issued for passenger cars and those for commercial vehicles are issued on a limited basis.

Indonesia: Progressively stringent local content regulations are being instituted in the motor vehicle industry although lags in component manufacture are slowing implementation. While the Government hoped to achieve full local manufacture of components for the most popular types of passenger and light commercial vehicles by 1984, it has extended this deadline until an unspecified date for components not yet manufactured in Indonesia or not manufactured in sufficient quantity. Presently all passenger vehicles, and all commercial vehicles imported into Java and Sumatra, are to be imported completely knocked-down. Import tariffs on built-up passenger vehicles range from 30 percent plus a 10 percent sales tax on jeeps to 200 percent plus a 20 percent sales tax on passenger cars. There are no export requirements or quantitative restrictions. Local assembly plants produce the following makes of passenger cars: Suzuki, Datsun, Hino, Landrover, Holden, Isuzu, Volkswagen, Mercedes, Mitsubishi, Renault, Peugeot, Alfa Romeo, BMW, Dodge, Fiat, Tata, Steyr, Citroen, Berliet, Moskvitch, Subaru, Volvo, Ford, Toyota, Honda, Chevrolet, Bedford, Morina, Daihatsu, and Mercedes-Deutz.

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Israel: There are no local content or export requirements maintained by Israel. Import duties are from 40 percent plus 2.50 shekels per kilogram for automobiles with engines 1,800 cc and less and 52 percent plus 1.25 shekels per kilogram for cars with engines 1,801 cc and larger. In addition, there is a purchase tax based on engine size which ranges from 85 percent to 150 percent plus a 5-7 percent import price uplift. These are assessed on a cascade basis. There are quantitative requirements attached to import licenses which are only granted to approved importers. Three Israeli firms assemble Ford cars: Ford, Dodge, Reo and Mack Trucks and AMC Jeeps. One local firm produces its own brand of trucks and passenger cars.

Kenya: No local content regulations exist but components manufactured locally may not be imported. Commercial and certain other vehicles are permitted to be imported only completely knocked-down. There are no export requirements. An import license accompanied by a 100 percent refundable prior import deposit is required. Import duties (CIF) on assembled passenger cars (other than public service-type vehicles) range from 40 percent for cars with an engine capacity not exceeding 1,200 cc, 75 percent for cars with a 1,751-2,000 cc engine capacity, to 150 percent with an engine capacity exceeding 2,250 cc. The duty on non-public service passenger cars, unassembled, for assembly into complete vehicles by an authorized assembler is 25 percent. Importers have been directed to seek 90-180 days credit overseas. The four authorized assemblers are Leyland Kenya Limited, General Motors Limited, Associated Vehicle Assemblers Limited and Fiat Kenya Limited. GM assembles Isuzu and Bedford trucks, British Leyland assembles trucks, Landrovers, Volkswagen microbuses and Mitsubishi light buses. Associated Vehicles assembles Datsun cars and buses, Peugeot trucks, Toyota trucks, Ford trucks, and Volvo trucks.

Import protection is accorded to local producers of the following automotive components: sealers, adhesives, batteries, tires, tubes, paints, flat glass, canvas, soft trim, upholstery, insulation, radiators, exhaust systems, leaf springs, spare wheel carriers, seat frames, wiring harnesses and brake linings.

Kuwait: There are no general restrictions on vehicle imports. A 4 percent ad valorem import tariff is in effect.

Malaysia: Under the ASEAN Automotive Federation (AAF) scheme for complementary ASEAN production, Malaysia will produce timing chains for cars; and spokes, nipples, and roller chains for motorcycles. Trade preferences by other ASEAN members would be granted these parts. Probably no further accreditation of additional capacity for the same product would be allowed until the ASEAN Committee on Industry, Minerals, and Energy determined that the market had expanded sufficiently to warrant further accreditation of similar projects.

Mexico: Local content regulations requiring 70 percent for passenger cars and 80 percent for trucks exist with a planned 5 percentage point increase of both in 1981. Imports of components are required to be offset by exports. Vehicle import duties range from 75 to 100 percent ad valorem. Vehicle imports are not allowed with the exception of a special customs zone near the U.S. border. Exceptions are usually only made if there is a shortfall in domestic supply. Chrysler, Volkswagen, Ford, GM and Nissan manufacture/assemble cars and trucks. American Motors produces cars and jeeps. Renault produces cars.

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Morocco: Local content regulations requiring 40-50 percent levels are in effect. All vehicle imports are restricted. All assembly operations are in part or totally Moroccan-owned. Through this system, Fiat, Opel, Simca, and Renault automobiles are assembled in Morocco. Berliet, Volvo, Bedford, Ford, DAF, Landrover, and Jeep utility, and industrial vehicles are assembled.

Nigeria: A 30 percent local content regulation is imposed after three years of assembly. Vehicle imports are restricted by import licenses and passenger vehicles with engines over 2,500 cc are prohibited. Passenger vehicles with smaller engines face duties of 50 to 250 percent. Volkswagen manufactures/assembles cars and minibuses. Peugeot manufactures/assembles cars. British Leyland manufactures/assembles trucks and Landrovers. Stayr manufactures/assembles trucks. Mercedes and Fiat will shortly begin to manufacture trucks and Nissan will start manufacturing automobiles.

Pakistan: There are no local content regulations as such but current use of locally produced components is encouraged by regulation and is reported to range from 26-40 percent of value depending on vehicle type. Projected use of local products is reported to be about 80 percent by 1985. Exports and imports are controlled. Commercial vehicle imports are prohibited. Imports of built up passenger vehicles are dutiable (75-350 percent *ad valorem*) depending on engine size. A state-owned corporation has a monopoly over the automobile industry. It has assembly arrangements with AMC (jeeps), Chrysler (trucks), GM (Isuzu trucks) Vauxhall (trucks and buses), Ford (minibuses), Suzuki (vans and pickups), Nissan (trucks), Toyo Kogyo (buses), Sumitomo (trucks), and Hino (trucks). This monology (PACO) controls the import of both completely knocked down and completely built up vehicles. Completely built up imports are limited to those being brought in by returning expatriate Pakistanis (6 months or more continuous stay overseas).

Philippines: The current local content regulations requirement is 62.5 percent. The import tariff rate varies from 30-72 percent for completely knocked down vehicles to 100 percent for assembled vehicles. There are three local automobile companies. One assembles Mitsubishi products and one assembles Volkswagens. The other assembles its own vehicles (the Tamaraw utility vehicle, a mini cruiser military vehicle and various trucks). Ford has a body stamping plant and automobile assembly facilities. GM assembles cars and trucks, and manufactures transmissions.

Portugal: Local content regulations for vehicles assembled in Portugal are 22 percent in 1980 declining to zero in 1985. Current import quotas for completely knocked down and completely built up vehicles are scheduled to end in January 1985. Import duties for non-EC/EFTA source vehicles is approximately 4.5 U.S. cents per kilogram. Import quotas are scheduled to be phased out by 1985. GM, Ford, Renault, Citroen, Alfa Romeo, British Leyland, Peugeot, Talbot, Audi, BMW, Mercedes, Volkswagen, Toyota, Nissan, Mazda, Subaru, Honda, and Daihatsu have assembly operations in Portugal.

Saudi Arabia: There are no local content regulations or import restrictions. The import tariff is 3 percent of CIF value. Mercedes assembles trucks. A Saudi firm assembles buses using American-made chassis. The Saudi Arabian Government provides a subsidy to the National Company for Car Manufacturing, located in Jidda, in the form of an interest-free loan.

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Singapore: There are no local content regulations or quantitive restrictions on vehicle imports. Import tariffs are 45 percent. There is a 150 percent additional registration fee, a $1,000 base registration fee for private and rental cars ($5,000 on company cars), and scaled road taxes. Mercedes, Ford, British Leyland and Volvo produce cars. Nissan produces vans.

South Africa: Passenger cars must contain 66 percent by weight local content. Starting in 1980, the local content regulations have been extended to light goods vehicles (approximately up to 2,800 pounds). The 1980 and 1981 requirements for these are 50 percent by weight. By 1982 these too must meet the requirement of 66 percent. Import licenses are required, but are granted to meet the full and reasonable requirements of components and subassemblies for passenger and light goods vehicles covered by a currently valid manufacturing program approved by the Minister of Economics. There are no export requirements. Fully manufactured cars may be imported without a license, but the duty is 100 percent. Excise tax for cars with less than 66 percent local content is 95 percent. For those with 66 percent local content, the excise duty per Rand value is a maximum of 13 Rand cents. There are excise duty decreases for percentages of local content achieved beyond the minimum 66 percent.

Nissan, Fiat, Ford, GM, British Leyland, Mercedes. Volkswagen, Sigma, and UCDD produce automobiles and trucks. Alfa Romeo, BMW, and Peugeot produce autos. Toyota South Africa produces its own brand of autos and trucks and assembles Renault autos and trucks.

South Korea: There are four auto manufacturing companies in Korea - Kia, Hyundai, Saehan, and Shin Jin. The first three companies also manufacture buses, and two - Hyundai and Saehan - manufacture trucks.

The tariff rate for automobiles is 80 percent.

Automobiles and auto components are on the "Restricted List", meaning prior approval of the Auto Trade Association is required before an import license can be issued. With regard to 100 percent foreign-made cars, the Association will issue import licenses depending on the "supply and demand situation" in Korea; however, such licenses are rarely approved.

Local content requirements are set by the Korean government for domestic manufacture and assembly of all cars, trucks, and buses. Those for cars, effective January 1, 1980, are as follows:

Makes	Type of vehicle	Local content requirement (Percent)
Kia	Brisa	94
-	Brisa II	92
-	Fiat 132	62
-	Peugeot 404	20
Hyundai	Pony	93
-	Cortina Mark IV	62
-	Granada	21
Saehan	Gemini	88
(Cars)	Rekord	65
Shin Jin	Jeep (J-5)	73
-	Diesel Jeep	91

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There are no specific export requirements *per se* for Korean auto manufacturers, although there are export targets and some moral pressure to meet those targets. According to the Korean auto industry association, however, there is one stipulation imposed on Hyundai and Kia: in order to obtain permission to import one knocked down Ford Granada or Peugeot 404 for local assembly and sale, the companies must export five domestically manufactured passenger cars.

Taiwan: Current local content requirement for vehicles is as follows: automobiles (including sedans, wagons and jeeps of 1.5 tons and below): 70 percent with proviso that manufacturer must produce one of the following components: (1) engine, (2) piston, connecting rod, and piston pin, (3) crankshaft, (4) axle transmission, (5) spring, (6) cylinder valve. Light motor vehicles (including truck, pick-up, and station wagon of 1.5 tons and below): 70 percent with proviso similar to sedans. Import duties on automobiles are from 45 percent to 75 percent depending on type.

Tanzania: No local content regulations exist. Imports are limited almost entirely to the government. Import tariffs vary from 40-100 percent depending on engine size. Except for trucks, the only automobile assembly operation is by British Leyland.

Thailand: Local content regulations requiring 35 percent local sourcing by August 1980 increasing annually to 50 percent in 1983 are in effect. Imports of built up passenger cars are prohibited. Duties of 150 percent are levied together with a 40 percent business tax on imported automobiles. Toyota, Nissan, Isuzu, and Ford produce cars, trucks and buses. Hino produces trucks and buses. Fiat, British Leyland and Volvo produce cars and buses. Mitsubishi, Mazda, Daihatsu, Subaru, GM, Volkswagen, Peugeot, Renault, BMW, Alfa Romeo, Citroen, Lancia, and Audi produce cars.

Turkey: Local content regulations are contained in the "Assembly Industry Regulation" enforced by the Turkish Ministry of Industry and Technology. Locally produced items are not permitted to be imported. Therefore, importation of automobiles is not permitted except under special circumstances. Import tariffs are 175 percent. Automobiles are produced under license from Ford (the Reliant Motor Company of U.K.), Fiat and Renault.

Uruguay: Local content regulations are in effect requiring local content of 25-32 percent of vehicle weight. Imports of automobiles are prohibited. Export regulations require the export of 40-105 percent (depending on vehicle type) of the import value of the completely knocked down kits the assembler imports. Peugeot-Citroen, Renault, Volkswagen, BMW, Ford, GM, and Fiat assembly automobiles in Uruguay.

Yugoslavia: Local content regulations require 50 percent local content to avoid imposition of higher sales taxes. Imports from other countries are only permitted by authorized dealers. Import tax on vehicles is 17 percent *ad valorem* and the duty is 25 percent. Authorized dealers are required to export goods totaling 30 percent of the value of each imported automobile. Quotas are maintained on imports from the USSR, East Germany, and Czechoslovakia and may be paid for in local currency. Other imports must be paid for in hard currency. Fiats, Ladas, Volkswagens, Audis, and Citroens are manufactured locally.

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APPENDIX B.—SUMMARY OF AUTOMOBILE TRADE RESTRICTIONS [1]

	Local content requirements	Nontariff import restrictions [2]	Export requirements	Current auto tariff [3] percent
Australia	Yes	Yes	No	35–57
Austria	No	Yes	No	20.0
Belgium	No	Yes	No	10.8
Brazil	Yes	Yes	Yes	185–205
Canada	No	No	No	14.2
Denmark	No	No	No	10.8
France	No	Yes	No	10.8
Germany	No	No	No	10.8
Italy	No	Yes	No	10.8
Japan	No	No	No	[4] 0.0
Mexico	Yes	Yes	Yes	NA
Netherlands	No	No	No	10.8
New Zealand	No	Yes	No	55.0
Norway	No	Yes	No	7.6
South Korea	Yes	Yes	Yes	80.0
Spain	Yes	Yes	No	68.0
Sweden	No	No	No	9.0
Switzerland	No	No	No	[5] 10.0
United Kingdom	No	Yes	No	10.8
United States	No	No	No	2.9

[1] The measures cited in this chart are for new cars. Trade restrictions on used cars are not reflected.

[2] Import restrictions apply to non-tariff measures maintained by a country which deal solely with imports. Tax measures which apply to both imports and domestically produced products are not included. Recent Japanese voluntary export limitation commitments are excluded, but countries receiving such commitments are asterisked.

[3] Most European countries impose hefty value-added taxes (VAT's) that make the effective tariff rate higher than shown.

[4] While no tariff is charged, Japan erects a complicated set of hurdles: unusual emmissions tests headlight color rules etc. These are not "import restrictions." however, because they apply to domestic and imported cars alike. NA=Not applicable: imports prohibited except by special arrangement.

[5] Average.

Source: Ford Motor Co., Japan Economic Journal.

APPENDIX C.—FOREIGN SOURCING

[Partial list of known 1977–81 commitments by major U.S. automobile manufacturers to purchase foreign-made major components for use in domestic nameplate vehicles]

Manufacturer and component	Intended for	Source	Approximate number of components	Delivery beginning
GM				
2.8 liter V–6	Cars	GM de Mexico	400,000 per year	1982
2.8 liter L–4 with transmission.	Mini trucks	Isuzu (Japan)	100,000 per year	1981
1.8 liter diesel L–4	Chevette	Isuzu	small numbers	1981
1.8 liter diesel L–4	S-Cars	Isuzu	NA	1983
1.8 liter L–4	J-Cars	GM de Brazil	250,000 per year	1979
THM 180 automatic transmission.	Chevette	GM Strasburg (France)	250,000 per year	1979
Manual transmissions	J-Cars	Isuzu	250,000 per year	1981
Ford				
2.2 liter L–4	Cars	Ford-Mexico	400,000 per year	1983
Diesel L–4	Cars	Toyo Kogyo (Japan)	150,000 per year	1983
2.0 liter L–4	Mini trucks	Toyo Kogyo	100,000 per year	1982
2.3 liter L–4	Cars	Ford de Brazil	50,000 per year	1979
Diesel 6 cyl	Cars	BMW/Steyr (West Germany/Austria).	190,000 per year	1983
Diesel 4 cyl	Cars		NA	1985
Manual transaxles	Front drive cars	Toyo Koyo	100,000 per year	1980
Aluminum cylinder heads.	1.6 liter L–4	Europe, Mexico	NA	1980
Accessory Motors	Cars, trucks	Ford-Singapore	NA	1984

APPENDIX C.—FOREIGN SOURCING—Continued

[Partial list of known 1977–81 commitments by major U.S. automobile manufacturers to purchase foreign-made major components for use in domestic nameplate vehicles]

Manufacturer and component	Intended for	Source	Approximate number of components	Delivery beginning
Electronic engine control devices.	Cars	Tashiba	100,000 + per year	1978
Ball joints	Cars	Musashi Seimibu	1,000,000 per year	1980
Chrysler				
L–6 and V–8 engines	Cars	Chrysler de Mexico	100,000 per year	1982
2.2 liter L–4	K-body	Chrysler de Mexico	270,000 per year	1981
2.6 liter L–4	K-body	Mitsubishi (Japan)	1 million	1981
1.7 liter L–4	Omni/Horizon	Volkswagen (West Germany).	1.2 million	1978
Manual transmissions	Omni-Horizon	Volkswagen	500,000	1978
1.6 liter L–4	L-body	Talbot (Peugeot)	400,000 total	1982
2.0 liter Diesel V–6	K-body	Peugeot (France)	100,000 per year	1982
1.4 liter L–4	A-body (Omni replacement)	Mitsubishi	300,000 per year	1984
L–4 engines	Cars	Peugeot	NA	1985
Aluminum cylinder heads.	2.2 liter L–4	Fiat (Italy)	NA	1984
AMC				
Car components and power train.	AMC-Renault	Renault in France and Mexico.	300,000 per year	1982
VWA				
Radiators, stampings	Rabbit	VW de Mexico	250,000 per year	1979
L–4 diesel and gas engines.	Cars	VW de Mexico	300,000 + per year	1982

NA=Figure not available.

Sources: Automotive News, Ward's Engine Update, Ward's Automotive Reports, American Metal Market, Detroit Free Press, Detroit News, Japan Economic Journal, and Journal of Commerce.

Chairman GIBBONS. I realize we have a difference of opinion on this but I want to thank you for your testimony. I am looking at some figures here published by the U.S. Department of Commerce, and I don't know that they are inaccurate. I am always skeptical of all figures. It has capital goods, billions of dollars—we talk about composition of U.S. merchandise trade—capital goods in billions of dollars, and it shows that we have been running a surplus all through 1981 and 1982. The surplus figures I am going to give you now are by the quarters.

There is no sense in me going through all of them. They rank all the way from $50.3 billion in one of the quarters to $39.7 million. These are capital goods surpluses. This is exports over imports. The exports, the most recent figure for the second quarter of 1982, exports amounted to $75.6 billion and imports only amounted to $35 billion. So while we are running—and I imagine a lot of your members are involved in the manufacture of capital goods—we were running a $39 billion surplus.

Now, suppose the people that are buying that impose domestic content, what is going to happen to those jobs, those very good AFL-CIO jobs in the manufacture of capital goods?

Mr. DENISON. I assume, Mr. Chairman, that the customers abroad will continue to buy in the marketplace the way they always have. They have been getting the best deal here, and they made their purchases accordingly. I can't see that changing because of a content requirement involving automobiles. It certainly shouldn't apply in the area of turbines or generators.

Chairman GIBBONS. That is the same argument. That is my argument. If it is going to work in the automobile industry, it is sure going to work in these capital goods industries. How about foods and beverages; we ran a surplus. We run a surplus of $29 billion or $20 million a year in foods and beverages, and I am sure a lot of your people are involved in the production of food and beverages are servicing those industries. And we ran a surplus of $19 billion in the second quarter of 1982 in foods and beverages. Suppose they all start pushing domestic content for that?

Mr. DENISON. No, I think that holds at this moment, but if any of those industries were to be targeted and decimated as a result of imports into this country, we would then lose them, whether they are generators, or turbines, or heavy manufacturing, or whatever it may be.

At this moment we happen to be targeted in the automotive industry. We could perhaps make the same argument about what happened to the electronics industries, to television, radios, home recorders in this country. Those industries are gone, and had we done something at the proper moment, we would at least have those industries here, and they would be providing jobs.

Chairman GIBBONS. I am just trying to point out that you have a lot of constituents. I am sure you realize this. You are a very intelligent organization that is involved in the exportation of goods that are very labor intensive, and the people are doing real well in the exportation of these goods. I think that, certainly, the longshoremen are going to lose some jobs. Longshoremen in my area will lose jobs.

Mr. DENISON. We don't think that is necessarily true. If they are bringing into this country additional goods that employed persons will buy, then their jobs will be in the loading and unloading, or particularly unloading, of different kinds of cargoes.

Chairman GIBBONS. I will bring my longshoremen in to talk with you. I would like you to explain that to them and the workers down there on my docks that are unemployed right now.

Mr. DENISON. Mr. Chairman, we have had extensive discussions with the longshoremen on this issue, but the AFL-CIO executive council, on which the president of the Longshoremen's Union sits, adopted this position unanimously and it was supported, I know, without a single dissenting voice in convention.

Chairman GIBBONS. As I say, I am not going to get into your business, because obviously you know a lot more about it than I do. But just looking at these national figures, it seems to me that many of your members, their jobs are at risk when you start saying this is the way to solve a problem. I admit we have got a problem that needs to be solved. But I just don't think that this is the appropriate way to solve it. I think they are going to end up very well having to eat the words "domestic content."

Mr. DENISON. Ms. Jager would like to comment.

Chairman GIBBONS. Certainly.

Ms. JAGER. Mr. Chairman, I think the figures you cite are certainly the ones that the Government issues and are correct to tell the story on an overall basis in a given period of time, but I think that if you look at the details of those data over the years, that through the years this has been the argument against ever doing anything about a problem, because we had a temporary surplus in that particular item.

We used to have this kind of a surplus in automobiles. We had a surplus in steel, and each time that any industry came in and asked for any help they were told that the world would fall in and we would go back to Smoot-Hawley, and unfortunately those industries are now gone or expired.

What we are saying is that there are serious problems in many of the capital goods industries in part, and that we need help to continue the exports. We also need help to make sure that the jobs in food and beverages are in fact the result of processing of food and beverages. We would like to make sure that the exports of foods and beverages include processed foods, to the extent that we can.

But the macro impression that is left by a capital goods overall figure, I am afraid, doesn't give us a lot of comfort, because of our experience in following so many industries where for a long period of time we had a surplus. But now we seem to be trending toward deficit in virtually every manufacturing industry.

From June of last year to June of this year, there was a $10 billion turnaround from surplus to deficit in manufacturing trade, and we think this is a matter of enormous concern.

Chairman GIBBONS. I am concerned about it, and of course this is an interrelated problem, as all of us know, of the value of the dollar in relation to other economies, and our competitiveness and productivity. It is not a simple thing.

I realize that these simple figures I am giving you don't tell the whole story, but I notice we had witnesses earlier today who were comparing us with European countries, and I just have some figures here. These were increases in exports between 1980 and 1981.

The United States increased almost 6 percent. France decreased about 8 percent. The Federal Republic of Germany decreased 8.5 percent. We don't even keep track of the Italian exports, at least not in this publication, because their economy is in such difficulty that we can't compare ours to theirs.

I just think that what we do in America we are doing pretty well. I don't want to emulate the Japanese. I don't want to emulate the European economies who I am convinced are inefficient. Their Socialist practices are going to bankrupt their countries, and we are going to lose a huge market. But I think there is an American way and we can improve on the American way. I hate for us to turn inward and take a very defensive position.

I make an analogy to my World War II experiences—the worst thing you could do when the going got rough was to start digging holes. There was a tendency to dig holes because you always felt safer, but you really ended up getting slaughtered when you started digging holes. I would rather us move out in new and inventive ways. I think we can, working together, figure out those ways. But I realize we have a complicated problem on our hands, and I look forward to working with you.

I am trying to recognize people in the order of their appearance here today. Mr. Frenzel, then Mr. Schulze, Mr. Brodhead, then Mr. Vander Jagt, then Mr. Pease.

Mr. **Frenzel**. Thank you, Mr. Chairman.

I want to thank the witness for his testimony. I had to absent myself for a few moments, and I hope I didn't miss something that I shall ask on. If I ask questions that you have dealt with, simply answer it with that comment.

You indicated that the administration or somebody was talking about a $1,000 increased cost on a car. I did want to point out that CEA yesterday used the figure $470 per automobile.

The Congressional Budget Office in its revised estimate chose two-thirds of its original estimate, which was $500, which took it down to $333. The difference, I am told, is that CEA was a derivative and CBO was the chosen assumption, and one was something that was worked from and one was something that was worked to. But certainly even under the CBO estimate, which is the least worst that I have seen, the prediction was still for a general disadvantage to the economy.

I take it you don't believe in the CBO logic. Would you comment?

Mr. **Denison**. I think, first, what bothered us was the statement that it was $1,000 and then off the top of the head it was $1,500 by Ambassador Brock. And it seemed a rather reckless throwing around of figures which didn't seem to have any basis, and now we are talking about $333 and then we are talking about some fraction of that.

It just seems that if the AFL-CIO came up here and were that loose with its figures we would get our knuckles rapped because we didn't have the proper attribution. It is just our concern that there seems to be a great deal of shrillness. In my years of coming up here, this is the most shrill reaction I have ever seen by an administration to a piece of legislation and I just find it hard to accept that, and I guess the $1,000 to $1,500 figure represented that excess of reaction.

Mr. **Frenzel**. I don't know which person said it. It doesn't appear in the printed remarks.

Mr. **Denison**. It was in the Q and A yesterday.

Mr. **Frenzel**. For your information, the official figures given to the committee were the ones that I have quoted and do appear in the record, but I do want to tell you too that there are a lot of us who feel shrilly about this bill. We face a lot of different kinds of bills in this committee, but we have never faced one that has absolutely upsidedowned the U.S. trade policy and threatened to wreak potential havoc in our economy like this one.

I can understand the strong feelings of those who support the bill. I hope those who support it understand the at least equally strong feelings of those of us who think it is a bad bill for America, because it is going to cost more jobs than it creates, but getting back to the testimony, according to Ambassador Brock, and there is a differential here too, foreign automobiles increased or the sale of foreign automobiles, between 1977 or 1978, increased by 200,000.

In the figures presented us by Mr. Fraser this morning, he shows an increase of 300,000. At the same time, the sale of automobiles overall decreased nearly 3 million; that is about 2.9.

It looks like 11 percent of your misery occurred because people decided to choose foreign cars, and perhaps 89 percent because Americans decided not to buy any kind of cars.

Why do you choose on that kind of basis to go after the Japanese automaker?

Mr. **Denison**. I think first of all the figure for the Japanese contributes in part to the decline in sales of the other side, if laid off workers are no longer in their jobs, and that is going to apply to the decline in U.S. auto sales as well, but, second, 11 percent is a sizable hunk of any market, and you get to a tilt point in an industry as to whether a foundry will remain open or a steel mill will remain open, and if there are no orders or the orders decline beyond a certain level, then they are inclined to close down and that ripple effect is then attributed to something else and not necesarily to autos because the orders came from other sources as well, but the auto is the tilt point. The announcement only today of Bethlehem Steel closing down all of its west coast operations now and going out of the steel business out there has to have some automobile portion to that announcement, to bring this about.

Now, how would that be measured in the terms of the statistics as to whether that is auto-related or recession-related or import-related I am not quite sure. All I know is that when one reaches a penetration of a market to the degree that the Japanese automobiles have reached, I recall the words of Henry Ford II not too many years ago who said we have a very serious problem in this country when imports reach 5 percent, and we are well past that point, so if we are at 25 or 30, then we have six times the problem that he saw a decade ago.

Mr. **Frenzel**. I also note that you indicate between June of 1981 and June of 1982 employment in the industry fell by 113 percent.

As I understand it, there was no increase in imported automobiles during that period.

Mr. **Denison**. June 1, 1981, and June 1982?

Mr. **Frenzel**. Yes.

Ms. **Jager**. That wouldn't necessarily mean that the imports of automobiles didn't contribute to the unemployment. You don't have to have a rise of penetration necessarily to cost more jobs.

Mr. **Frenzel**. Of course, which came first, the chicken or the egg?

Ms. **Jager**. No, but if you have a consistent penetration in a declining economy, you are costing jobs with the imports. Unfortunately, it still can be a factor. We haven't claimed that every job is 1-for-1 related. We are simply giving a sense of the enormity of the problem.

Mr. **Frenzel**. I think you have a great deal of trouble associating any kind of a relationship there.

On page five at the bottom you indicate that H.R. 5133 creates some sort of economic justice because it gives an opportunity for manufacturers from all nations to sell and produce cars here.

What would happen if Japan or the European Community had an open invitation for us to sell them all the corn and soybeans and wheat we wanted to as long as we grew it in their country?

Mr. **Denison**. I think if they had the opportunity, they would make exactly that kind of an offer, if they could do it for agricultural goods, because they have already done it for manufactured goods, precisely that.

Mr. FRENZEL. So you don't care what happens to our export trade?

Mr. DENISON. Of course I care. We care to a great degree about that, but I have talked to representatives of the farming community, including the Farm Bureau, who tell me that if the economy in Michigan were to turn around to what it was 5 years ago, they would sell more in the State of Michigan than they will sell in Japan.

Mr. FRENZEL. Were you aware that Secretary Baldrige yesterday testified that four out of five new jobs created in the last 5 years in this country were by export industries?

Mr. DENISON. I would think that that is possibly, probably true, if the basic manufacturing industry is under the terrible threat it is in. The export industries could be——

Mr. FRENZEL. Would you limit the growth to protect those that are suffering now?

Mr. DENISON. I am sorry. I didn't hear.

Mr. FRENZEL. You are willing to write off the growth to protect those?

Mr. DENISON. No, I don't see that there is any relationship between the two. Those export-related jobs are there because there is a desire for those products abroad. They are either not manufactured there or they fit a particular need.

If they were manufactured in those particular countries, and those countries could exclude our product, they would do so. I think the recent evidence in what is happening in the Japanese aircraft industry is a case in point. What bothers us even further is that when American workers are told they are no longer productive, and we are told that America no longer has high technology, we read in the newspapers where McDonnell-Douglas and other firms are selling aircraft technology to the Japanese in order to put them in the business of producing the next generation of commercial aircraft. So commercial aircraft is where the new loss to export jobs will come, when all of that industry is transferred abroad.

Mr. FRENZEL. You are aware that we buy a fair amount of technology from the Japanese as well, which is producing jobs in the United States.

According to the Council of Economic advisers, each additional job created in auto and related industries would cost consumers about $100,000 in higher prices.

This is approximately four times the annual earnings received by a full-time UAW worker.

Now, if you take what you guys usually call a trickle-down part of that stimulus, you can get the net cost down to $60,000 per job, or a total of $4 billion.

Wouldn't it be nicer to ask for an appropriation of $4 billion?

Mr. DENISON. Yes, and I think that to use the Department of Commerce figures is an invitation to declare national bankruptcy immediately because every new job we create is beyond our ability to pay for it. I think it is ludicrous.

Mr. **Frenzel**. It depends on whether you pay for it voluntarily or by choice in the marketplace, or whether it is a choice inflicted upon you.

For instance, if we tell people we cannot buy imported cars, as this bill does in fact, supposing they don't buy American cars and you don't get the relief? Supposing the recession deepens. What do you do then? Force them to buy a car?

Mr. **Denison**. No, but I think these become ludicrous examples or fantasies almost as to what if. These are the questions that I don't think are relevant.

First of all, these are not foreign cars that they are being denied the purchase of. These are automobiles that will no doubt be engineered or at least designed in Japan. They will be built to specifications to those corporations.

They will probably be virtually identical to the cars now being produced in Japan, so that the opportunity for choice remains exactly the same. There is no problem in moving equipment around.

I come from Michigan. I have worked in auto plants, and I have seen equipment moved in and out and they produce parts in Detroit 1 day and 2 days later they are producing them in Muskegon. The identical machinery is moved all around so there is no difficulty.

Mr. **Frenzel**. I agree with you except when there is a rail strike.

Mr. **Denison**. Well, the Japanese will fly them in, I am sure.

Mr. **Frenzel**. They may do that. Some of the economies are estimating that the Japanese will not take advantage of the wonderful opportunities which your bill presents.

Mr. **Denison**. I haven't heard any evidence of that.

Mr. **Frenzel**. We are going to ask them to come up here and tell us and I hope we will get some information on that from the folks who are in charge.

According again to the people who testified yesterday, we are going to create a few thousand jobs in U.S. automobile plants, and about three times that much, somewhere around 9,500 or 10,000, about three times that many in Japanese plants in the United States plus Japanese parts plants in the U.S. or suppliers, and it is going to take, of course, until 1985 for that to come about.

It seems to me by any study you are putting an awfully high price on consumers and upon Ford workers and export industries jobs for a very small number of American jobs; you are risking very severe dislocation in the world trading system. I take it you are willing to take this risk?

Mr. **Denison**. I don't see that that is the case. If that were the case, we would be probably taking a different view of this legislation, but we don't see a direct relationship between export-related jobs being threatened in industry by the creation of this kind of an industry.

When we had our regional meetings around the country, we had workers there from all industries, and every one of them saw this as being beneficial to them.

No one said, hey, what is the threat to my industry that is potential here, and they have sophistication on this issue.

They have learned the hard way over many years, as they have watched their industries decline.

Mr. **FRENZEL**. Those are the ones who weren't alive in the thirties.

Mr. **DENISON**. Who weren't alive in the thirties? Some were.

Mr. **FRENZEL**. They don't know what happened to them the last time we tried this.

Mr. **DENISON**. Well, I don't know, if we are going to insist this is comparable to Smoot-Hawley, then again I think that is a shrillness that is unnecessary, particularly when we live in a world today of nations with content requirements and they are all doing rather well.

Mr. **FRENZEL**. Did you ever drive a car made in Brazil, Australia, or Greece?

Mr. **DENISON**. Not knowledgeably, not to my knowledge.

Mr. **FRENZEL**. Don't.

Mr. **DENISON**. I will take your word for it.

Mr. **FRENZEL**. I think the witness has given excellent testimony on the whole.

Chairman **GIBBONS**. Mr. Schulze?

Mr. **SCHULZE**. Thank you, Mr. Chairman. I too would like to thank the gentleman for his testimony.

I would like to follow up on the chairman's line of questioning or his statement. I have the same chart to which he was referring. The thing that stands out as I look at our capital goods balance, it has gone from the second quarter of 1981, $50.5 billion to $39.7 billion, which is a drop of $10 billion. It seems to me capital goods is going in the wrong direction.

He neglected to add that in 1981 the deficit in automotive vehicles and parts was $11.7 billion; in the second quarter of 1982 it is up to $19.1 billion, which is almost another $10 billion lost, and our share of world exports has gone from 15.4 percent in 1970 to 13 percent in 1981.

It seems to me that we are going in the wrong direction. It seems to me that we are hearing an awful lot of talk about retaliation. Quite frankly, I don't think that this will create retaliation.

I think it might create a little bit of respect, and it may also, especially if it is done with the idea and the full knowledge that quite frankly this is retaliation, I think that is what it is, I think that is how it should be categorized, plain and simple.

If you are not going to play by the rules, even for other areas, I don't think we ought to limit it necessarily to automotive.

I have a question. I don't mean to put you on the spot with this, but does AFL-CIO have some kind of a "Buy American" program to encourage their people, their workers, to buy domestically produced automobiles?

Mr. **DENISON**. Indeed. The AFL-CIO has a union label trades department that encourages, publicizes both "Buy Union" and "Buy American", not in a jingoistic manner, but simply that while we appreciate and encourage trade, and would not say that we would want to close our borders, fortress America or any of that, but rather that where a product is made by an American worker, and it is union-made, particularly in the apparel industry where you hear on television, look for the union label, all of this is encouraged by the federation and we would hope that would be continued.

The problem is, as we all know, it is virtually impossible in many areas now to either find the union label or to find an American label, and the price of the product is high.

Mr. **Denison**. Specifically with automobiles.

Mr. **Schulze**. I would hope you would talk to some of your supporters on this legislation because, as I walk through the garage and see those really up here pounding the table in full support of this legislation and I see a foreign car parked in their slot, it looks awfully phony to me. It really does.

Maybe you ought to talk to some of these people.

Mr. **Denison**. I share your concern.

Mr. **Schulze**. I speak as one who has never bought a foreign car and you never see one in my spot, unless the automotive industry goes out of business, and I think perhaps we are headed that way.

Mr. **Denison**. But that sensitivity has only come in the last 2 or 3 years. Up to then if some people drove a foreign car OK, that was part of it, but now the feeling that there is no longer a fairness here, that we are being overwhelmed, the industry is being destroyed, then you get this kind of reaction such as Detroit's, "Park your Toyota in Tokyo." That reaction is becoming more prevalent.

Mr. **Schulze**. I agree, and I think it was perhaps pseudo-sophisticated to have a foreign car a few years ago. The realization of what it was doing to our economy was not really there.

I guess we all have to admit the automobile industry has had some problems in quality and other criticisms which are somewhat justifiable. I believe that we can overcome this and should. I would hope that just as this legislation moves through the legislative process, that we could get some reaction in other places in the world, and maybe it would not be necessary.

I am not happy with doing this. I don't think anybody is.

I would assume that you are not.

Mr. **Denison**. It might be the kind of a deterrent that will make it such that we will not have to do anything further.

Mr. **Schulze**. I think you are right, and that is why I do not look for retaliation. I don't share with those who are concerned that this will start a trade war around the world.

I think that quite frankly it is overdue. I think we have talked for a long time and gotten nowhere and the time has come for action.

I thank you for your testimony.

Chairman **Gibbons**. I don't know what the members want to do. We have a 15-minute vote on now, which is on the Conte motion to recommit the continuing resolution. The Conte motion, as I understand it, sets the expiration date on the continuing resolution simultaneous with the sine die adjournment of the Congress, and the continuing resolution, as I understand it, sets it at December 15.

Immediately following that, we will have a 5-minute vote on final passage perhaps. Do members want to continue or would they like to recess now and go vote? What would they rather do?

We have Mr. Vander Jagt and Mr. Pease.

Mr. **Vander Jagt**. I have no questions.

Chairman **Gibbons**. Well then, Mr. Pease, go ahead.

Mr. **Pease**. Thank you, Mr. Chairman. I think, given 7 or 8 minutes, I can dispose of my questions.

First, let me say I appreciate the testimony. I haven't had a chance to listen to it, but I have read it and appreciate having the testimony.

Mr. Denison, it will not be any surprise to you to be reminded of my concern about the consequences of unemployment in the auto industry and the industrial sector generally, and the interrelationship between the Government, what the Government does pursuant to its free trade policy to help those people who are suffering from the benefits of free trade.

Mr. Bailey, in his questioning this morning, I guess it was more of a comment than a question, raised that point also.

My understanding from the time I entered Congress in 1977 was, for example, that in 1974 there was a compact of sorts entered into between the Government and the auto industry and other affected industries to the effect that in return for concessions on trade restrictions, which would theoretically benefit all Americans, those industries which were most likely to be affected in terms of employment would get some break in terms of helping the people who get hurt.

The TAA weekly benefits were an example of that. The TRA training program, although it was never adequately funded, was another example, and we are trying desperately this afternoon to get a quorum of members here so that we can mark up my efforts to extend the training program.

Could you comment for me on your own perspectives? What promises have been given to workers, real or implied, by the Government, or by the employers that need to be taken into account as we consider the need for legislation such as this?

Mr. DENISON. Mr. Pease, before my time up here, which goes back a few years, when trade legislation was moved on in the 1960's under the Kennedy administration, the feeling of the labor movement and the expressed opinion of the labor movement during all of that period was for a free trade posture. We diligently supported that, and when the legislation that took place in early 1960 came about, and the expressions were made by representatives of the labor movement that there was a fear that there would be some job loss as a result of tariff reductions and other changes made in trade policy, we were told that the American worker need not be worried; that he would be taken care of. In the words of John Kennedy, "No American worker will be left with an empty grocery bag." So we were assured that trade policies enacted by the Congress would not be at the expense of the American worker.

However, to be sure that that was going to be the case, a program of trade adjustment assistance was made a part of that legislation, and in fact we were told that there would be no more than 18,000 workers ever affected, even fractionally by the adjustments that would take place as a result of this policy, and that is where we got the title "Trade Adjustment."

Then for a period of years no workers received any of those benefits, even though applications were made and there was injury. Somehow or other, the law was always interpreted so that it did not apply directly in specific cases. It was only after 8 years that the Nixon administration, late in its years, made a decision that the law had not been enforced properly earlier. Thus, with the same language in the law, suddenly large numbers of workers were found eligible for assistance. So here we had this shifting of interpretation under the law in terms of how workers were going to be helped under the original legislation.

Then, of course, later we had the legislation in 1974 where the legislation was improved. Since then a massive number of workers were impacted and affected by imports. Claims filed and allowed made it a multibillion dollar program that was so costly it had to be modified, and in effect virtually strangled.

It is this kind of a history from 1962 to date in this one narrow area where we were told: Don't worry, everything is going to be all right, that things have not been all right; that workers have lost jobs far beyond anticipated, and then when the bill came due, the bill was not to be paid by the Government. So the compact you referred to has not been lived up to. Therefore, there has to be skepticism by any assurances to us as representatives of labor organizations to wait, that somehow or other through negotiation, somehow or other by jawboning, somehow the Japanese will listen to reason. It is hard to believe that we are going to receive an understanding of the trade crisis when we saw it was not fulfilled on adjustment assistance.

Mr. **Pease**. I appreciate those comments.

Will you agree with me that the reason for scaling back TAA so drastically last year appeared to be related not to the merits of the program and not to the needs of the laid-off workers, but strictly to the cost?

Mr. **Denison**. Indeed.

Mr. **Pease**. That was certainly my impression. Would you agree with that?

Mr. **Denison**. Indeed, absolutely. If by some miracle far fewer people had been impacted, I am sure the program would remain as it is today, but simply when it became of that size—and it was an embarrassment that we were showing by this amount of money being laid out of the failure of the trade policy—that it was not only a cost item for the budget, but it was also an embarrassment.

Mr. **Pease**. I would feel a lot better if I felt that workers who get laid off because of imports were still receiving some compensation for an adjustment period, and most important, were still receiving an opportunity to get retrained.

Right now that is not even possible, and unless we can get a quorum, we won't have a chance at all.

Mr. Chairman, I know that time is short. That was my chief question. I will yield back the balance of my time.

Chairman **Gibbons**. I hate to leave. I have a lot that I want to talk with you about. If you want to wait, we will be glad to have you do so, but it is not necessary.

We have one other witness, Mr. Turner, who will be next. We will be right back.

Mr. **Denison**. Whatever you want, Mr. Chairman.

Chairman **Gibbons**. That is all right.

Mr. **Denison**. Thank you.

[Recess.]

Chairman GIBBONS. Let us resume, and let me say I am being pushed to vacate this room by 4 o'clock because they have another event scheduled in here.

Let us now have Mr. Brian Turner, appearing in behalf of Mr. Howard Samuel. Mr. Turner is the director of legislative and economic policy for the industrial union department of the AFL-CIO.

Mr. Turner, we are glad to have you here.

STATEMENT OF BRIAN TURNER, DIRECTOR OF LEGISLATION AND ECONOMIC POLICY, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, ACCOMPANIED BY JUDY SCOTT, LEGISLATIVE REPRESENTATIVE, APPEARING FOR HOWARD D. SAMUEL, PRESIDENT, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, AND CHAIRMAN, COALITION OF AUTOMOTIVE COMPONENT AND SUPPLY WORKERS

Mr. TURNER. Thank you, Mr. Chairman. I am here today in place of Howard D. Samuel, our president, who is unable to be here this afternoon. We were under the impression this might be a morning testimony.

Chairman GIBBONS. I was too, but I can't control the time it takes.

Mr. TURNER. He is, regrettably, unable to join us this afternoon. I am here today testifying in support of H.R. 5133, the Fair Practices in Automotive Products Act, on behalf of a voluntary association within the AFL-CIO composed of 60 affiliated unions representing approximately 6 million workers, and also on behalf of the Coalition of Auto Component and Supply Workers, a coalition of 31 national and international labor unions affiliated with the Industrial Union Department, whose members produce parts, components, and supplies for automobiles.

The coalition represents workers—to a certain extent within the domestic auto manufacturing firms but largely outside of them—who produce steel, rubber, fabrics, wiring, electrical equipment, glass, aluminium, and other materials and components that go into finished automobiles and trucks.

No one can dispute the fact that the American auto industry is in bad shape today. Joblessness is at near record rates—not only for auto assembly workers but also for more than twice as many workers in supplying industries and for many more auto dealers, shippers, and service centers. The reasons, of course, are complex. Chief among them are devastatingly high interest rates and the huge influx of foreign cars—particularly from Japan—during the last decade.

The auto industry and related suppliers represent the largest manufacturing industry in America. Action to ameliorate the situation must be taken immediately to stop the exodus of American jobs to other countries and to prevent further erosion of the U.S. industrial base.

One of every five American jobs, according to a study released by this subcommittee, is linked to the auto industry. For every worker involved in auto assembly, there are 2.3 workers in component and supplying industries. The importance of the auto industry's position in the total economy is demonstrated by the industry's consumption of materials.

The auto industry uses 21 percent of the steel consumed in the United States, over 50 percent of the malleable iron, 34 percent of the zinc, 12 percent of the primary aluminum, 13 percent of the copper, and 60 percent of the synthetic rubber.

In light, Mr. Chairman, of the fact that the employment numbers have been touched on by other witnesses, I am going to skip over the next couple of paragraphs in the statement and go on to a discussion of international trade policy questions.

Unlike the situation in other markets, foreign auto producers have almost unfettered access to the U.S. market. In contrast to America's 2.9-percent tariff on foreign car imports, the European Community countries all impose 11-percent duties on auto imports, along with absolute quotas.

For example, Italy limits Japanese imports to 2,200 units per year, and France limits them to only 3 percent, now reduced to 2½ percent of its domestic market, while Great Britain permits Japanese imports of only 10 to 11 percent of total sales within Britain.

In Germany, the only major industrial market nearly as open as the United States, the Government also levies the 11-percent European Community tariff and has recently acted to limit Japanese sales to 10 percent of the German market. This action, by the way, has produced no sign of retaliation from the Japanese Government.

More than that, new beggar-thy-neighbor auto industry policies are rapidly proliferating among the advanced developing countries to the further detriment of the American auto and supplying industries. Most pernicious among these new policies are export requirements imposed on auto producers in Mexico, Brazil, and many other countries as a condition for the auto companies to operate in those markets.

Under the requirements of the Mexican Auto Decree of 1977, each American company and every other auto company operating in Mexico must export more automotive products from Mexico than they import into Mexico. The Government of Mexico has estimated that the decree will result in raising exports of Mexican auto parts from $650 million in 1979 to over $5 billion by 1985—with some 60 percent of the increase coming into the U.S. market. The result will be the loss of some 86,000 to 115,000 U.S. jobs or job opportunities, many in industries that need to be revitalized in the U.S. auto-related economy.

The impact on supplier industries from the auto decree is already manifest for producers of metal castings, wiring harnesses, trim, glass, and a host of other auto components. The most dramatic impact can be seen in new investments for fuel-efficient four- and six-cylinder engines—presumably the mainstay for a modernized American auto industry. Under the requirements of the Mexican auto decree, however, North American auto producers have built five of these new, modern, efficient engine plants in Mexico rather than in the United States—even though there was no apparent cost advantage to producing in Mexico.

In fact, some 60 to 80 percent of the output of these new engine plants will be shipped back to the United States for assembly into "American" automobiles. In Brazil, as of 1978, foreign auto producers had given commitments for the export of over $5 billion in automotive products as a precondition for their relatively unrestricted operation in the Brazilian market.

U.S. firms had committed to over $2 billion of these automotive exports from Brazil. More recently, early in this year, a new round of manufacturing export commitments were announced by the Brazilian Government totaling some $55 billion through the end of the 1980's. Most of those committed exports are in the automobile and machinery industries, and the bulk of those commitments were given by U.S. firms.

In addition, local content requirements on auto imports are mandated by over 30 countries. Under Mexico's Auto Decree of 1977, local content requirements were set initially at 50 percent per vehicle, but were scheduled to rise to 80 percent by 1981. The result of the decree will be reduced sales of U.S. auto parts to Mexico, reduced U.S. sales of vehicles to Mexican free zone areas, and increased shipments of Mexican parts to the United States. In Brazil, local content requirements are linked with export requirements.

I would like to step aside from the prepared remarks here, Mr. Chairman, to respond to something that was brought up yesterday by Ambassador Brock in testimony before this committee, which I did not witness personally but which has been reported to me, and that was to have him quote from a report that was prepared by the Labor-Industry Coalition for International Trade, a coalition in which 10 of the IUD's affiliated unions and the IUD participate along with an equal number of manufacturing firms. And he quoted a paragraph to the effect that this proliferation requirement of local contents abroad was a matter of grave concern to the future of American industry.

I must say we continue to agree with that, but our support and the support of every one of the unions in the Labor-Industry Coalition for this bill do not reflect any change in the views as to the fact that the United States is disadvantaged by the much more activist policies pursued in auto and in other sectors by other countries, compared with the more or less laissez faire situation which we experience here at home.

It is that gap which is the problem. In an ideal world, as others have said earlier today, if you could get those other countries to roll back their policies which disadvantage the United States, then perhaps we wouldn't have the problems we have today. But in fact we do live in a real world, not that ideal world, and we have concluded that after many months and more than that of pointing out the proliferation of these policies in other countries, there has been no sign of action by the U.S. Government to provide any kind of relief. And in that environment, we see no alternative but to move forward as we are doing in supporting H.R. 5133.

In addition, we have the direct problem of Japan which demands special attention. While the U.S. maintains an open market to the Japanese, Japan has erected an array of nontariff barriers to restrict the number of American vehicles that can be sold in Japan. These barriers include commodity taxes, inspection systems requiring inspections of each individual car, and limits on marketing networks. Such nontariff barriers can nearly double the price of American cars sold in Japan.

It hardly needs to be restated that the Japanese are not nearly so reticent about automobile exports as they are regarding automobile imports into their country. Japan's global auto exports have risen from 194,000 in 1965 to over 6 million units in 1981.

Indeed, even as U.S. auto producers were falling into depression-like conditions, the Japanese have continued to expand their sales into this country. Paradoxically, even in 1980, when U.S. auto-related unemployment was reaching depression levels, the Japanese auto manufacturers were announcing further additions to their productive capacity, even though they were already operating on overtime schedules, bringing them to a capacity level of the No. 1 automobile producer in the world.

The Japanese, in addition, have proven to be skillful negotiators whose hallmark is appearing to make concessions while actually giving up nothing at all. When the Japanese were finally brought to accept "voluntary" limits on their exports in the United States in the spring of 1981, they agreed to levels of exports designed according to Japanese industry definitions which resulted in no reduction in Japanese sales to the United States market.

With the further reduction in auto sales following record high-interest rates and the seemingly bottomless recession, the Japanese are once again in that favorite position of having their cake and eating it too, with the appearance of export limitations and the reality of strengthened market shares and rising profits.

Furthermore we have the situation of Japanese purchases of United States-made auto parts. In September 1980—and this is just one of a series of such examples—a highly publicized Japanese buying mission for auto parts came to the United States to meet with parts industry firms and with all of the concerned unions to express their good intentions to double and triple Japanese purchases of United States parts both for original equipment in Japanese cars—particularly for those sold in the United States—and for the burgeoning replacement parts market in this country.

The results are instructive: Japanese purchases in 1981 of United States-made auto parts actually declined in real terms over 1980 levels, contrary, of course, to the statements made by the spokesmen of their purchasing mission.

A hard look at the statistics is much more informative than tales of good intentions.

I would also like to bring your attention to Howard Samuel and others who were working in the Labor Department from 1977 to 1979. I was there working with them. We were concentrating in the executive branch and with Members of Congress to encourage the Japanese to build auto manufacturing facilities here where their markets were.

The Japanese Government and auto producers have continued to receive such encouragement to build where they sell. Nevertheless, the largest automakers from Japan have chosen to supply the U.S. market by running Japanese plants on mandatory overtime. Further, the Japanese Government has chosen to pursue economic policies that maintain an artificially undervalued yen, now at better than 260 yen per dollar, thus gaining an unfair exchange rate advantage, which since 1978 has risen more than 40 percent, and they have continued therefore to expand their market share in the United States.

It makes no sense for the United States to maintain virtually unlimited access to our markets while our access to markets of other countries is restricted at a cost of hundreds of thousands of American jobs. We believe that H.R. 5133 addresses this problem in a manner that is equitable both to foreign producers and American consumers.

I would like to call attention here, just in wrapping up, to several particular aspects of the bill which I think have been perhaps misunderstood. One is the claim by opponents and analysts and pundits that higher car prices and a trade war may result in the wake of the bill's enactment. The specter of skyrocketing auto prices arises from the misconception that price competition will somehow vanish. Recent history proves otherwise.

Since restraints on Japanese imports were applied in the spring of 1981, the price of U.S. cars has risen at the low rate of about 3 percent annually. In contrast, the Nation's inflation rate in the same period has been 8.7 percent.

As for the future, price competition should thrive rather than fade as foreign companies such as Honda and Nissan continue to seek a bigger share of the U.S. markets, but this time with U.S.-built cars.

Likewise, the specter of retaliation and trade war also seems highly unlikely. The real life context in which the bill will operate supports a very different appraisal of the bill's impact.

Of the major importers into this country, Volkswagen and AMC-Renault already meet the revised contents standards of H.R. 5133. Honda is close behind. In fact, only two companies fall dramatically short of the bill's standards, and they are the Japanese firms Toyota and Nissan.

Japan, however, has not launched trade wars against the 31 other countries around the world with restrictions on auto imports much stronger than those contained in H.R. 5133, and it is unrealistic to think that Japan, with a $13 billion surplus in auto trade with this country and with other discriminatory industrial policies that disadvantage U.S. producers, could retaliate by abandoning the U.S. car market or by freezing out the importation of U.S. goods on which Japan now relies.

Alternative sources for these items are found in countries like Australia, Argentina, and Brazil, countries which have in place tighter auto restrictions than those now in place in H.R. 5133.

Taking these circumstances into account, along with the fact that Japan has been reaping the benefit of an auto trade surplus with the United States that amounted to $13 billion in 1981, the likelihood of retaliation from them is minimal. And there is no prospect of retaliation from Europe, whose auto companies are not restricted in any way by the legislation now before the Congress. In short, the issue of retaliation is a red herring.

Let me add just one further thought, Mr. Chairman, which goes to a question which you have been raising here in the hearings throughout the day, and that is the question of the trade surplus which we enjoy in capital goods in this country. As the last witness has pointed out, the United States enjoyed a significant trade surplus in automotive products 10 years ago, and that has vanished.

We also see threats in the capital equipment sector, in areas like machine tools, in semiconductors, in computers, in fiber optics, in large commercial aircraft, and in heavy electrical equipment.

We believe that if the United States does not begin to look at the totality of this situation, including the auto situation, and take more decisive and vigorous action, then the highly laudable trade surplus which you emphasize will be only a memory a few short years from now.

I would be happy to answer any questions in the remaining time.

[The prepared statement of follows:]

STATEMENT OF HOWARD D. SAMUEL, PRESIDENT, INDUSTRIAL UNION DEPARTMENT, AFL-CIO AND CHAIRMAN, COALITION OF AUTOMOTIVE COMPONENT AND SUPPLY WORKERS

I am here today testifying in support of H.R. 5133, the Fair Practices in Automotive Products Act, as president of the Industrial Union Department, a voluntary association within the AFL-CIO composed of 58 affiliated unions representing approximately six million workers, and also on behalf of the Coalition of Auto Component and Supply Workers, a coalition of 31 national and international labor unions affiliated with the Industrial Union Department, whose members produce parts, components, and supplies for automobiles. The Coalition represents workers—to a certain extent within the domestic auto manufacturing firms but largely outside of them—who produce steel, rubber, fabrics, wiring, electrical equipment, glass, aluminum, and other materials and components that go into finished automobiles and trucks.

No one can dispute the fact that the American auto industry is in bad shape today. Joblessness is at near record rates—not ony for auto assembly workers but also for more than twice as many workers in supplying industries and for many more auto dealers, shippers, and service centers. The reasons, of course, are complex. Chief among them are devastatingly high interest rates and the huge influx of foreign cars—particularly from Japan—during the last decade. The auto industry and related suppliers represent the largest manufacturing industry in America. Action to ameliorate the situation must be taken immediately to stop the exodus of American jobs to other countries and to prevent further erosion of the U.S. industrial base.

DIMENSIONS OF THE PROBLEM

One of every five American jobs is linked to the auto industry. For every worker involved in auto assembly, there are 2.3 workers in component and supplying industries. The importance of the auto industry's position in the total economy is demonstrated by the industry's consumption of materials. In 1979, the auto industry used 21 percent of the steel consumed in the U.S., over 50 percent of the malleable iron, 34 percent of the zinc, 12 percent of the primary aluminum, 13 percent of the copper, and 60 percent of the synthetic rubber.

The unemployment rate for auto manufacturing in January 1982 was 24.9 percent—representing some 286,000 workers who have lost their jobs—as compared with an auto manufacturing unemployment rate of 5.0 percent in January 1979, according to the Bureau of Labor Statistics. Job losses in supplying industries as well are tremendous, bringing the auto-related industrial job loss figure to well over three-quarters of a million people. Motor vehicle parts and accessory workers account for the single largest portion of employment in the primary auto parts producing sector. Labor Department statistics show that between December 1978 and December 1981, the number of workers employed in this segment declined from 387,700 to 243,400—a drop of 144,300 jobs or more than 37 percent. Auto metal stampings, which account for nearly all sheet steel components in vehicles such as body parts, wheel covers, and trim, had an employment decline of 40,900 jobs, from 107,000 to 66,100—over 38 percent—during the same period. And the number of production workers supplying tires fell from 92,800 to 87,400 during that time span. Other industries that produce auto equipment as well as other goods also have been hit by increasing rates of unemployment as a result of the slump in the auto industry. Between November 1978 and November 1981, for example, employment in iron and steel foundries declined from 202,300 to 155,000—representing 47,300 workers and nearly one-quarter of the workforce in that industry. Employment in malleable iron foundries alone dropped 19,100 to 10,800—a loss of 8,300 jobs, or a decline of over 43 percent—during the same time period.

The astronomical unemployment rate among auto industry workers represents not only an economic drain resulting from lost revenues and additional spending for unemployment compensation, food stamps, and social services, but also reflects a psychological drain. The statistics do not reveal the devastating impact that the stress of unemployment has on workers, their families, and their communities.

While domestic sales and unemployment levels are declining precipitously, sales of imported cars are continually setting new records. The import share of new car sales has jumped from 17.5 percent in 1978 to 27.1 percent in 1981. Japanese imports are mainly responsible for the huge increases. Between 1973 and 1979, Japanese cars accounted for more than 76 percent of U.S. automobile imports. Nearly half of all Japanese exports came to the U.S.—easily their largest export market. In addition, American companies are obtaining an increasing percentage of parts from sources outside the U.S. As increasing numbers of imported cars travel U.S. roads, the replacement parts market for them has expanded greatly. Some foreign car manufacturers, however, have virtually shut out U.S. parts suppliers in favor of foreign suppliers. All these factors, in combination with our trade policies, have contributed to the rising number of unemployed workers in this country.

INTERNATIONAL TRADE POLICIES

Unlike the situation in other markets, foreign auto producers have almost unfettered access to the U.S. market. In contrast to America's 2.9 percent ad valorem tariff on foreign car imports (which is scheduled to drop to 2.5 percent in 1987), France, Great Britain, and Italy all impose 11 percent duties on auto imports, along with absolute quotas. For example, Italy limits Japanese imports to 2,000 units per year, and France limits them to only 3 percent of its domestic market, while Great Britain permits Japanese imports of only 10 percent of total sales within Britain. Germany, the only major industrial market nearly as open as the United States, the government also levies the 11 percent European Community tariff and has recently acted to limit Japanese sales in Germany.

New beggar-thy-neighbor auto industry policies are rapidly proliferating among the advanced developing countries to the further detriment of the American auto and supplying industries. Most pernicious among these new policies are export requirements imposed on auto producers in Mexico, Brazil, and other countries as a condition for the auto companies to operate in those markets. Under the requirements of the Mexican Auto Decree of 1977, each American and other auto company operating in Mexico must export more automotive products from Mexico than they import into Mexico. The government of Mexico has estimated that the decree will result in raising exports of Mexican auto parts from $650 million in 1979 to over $5 billion by 1985—with some 60 percent of the increase coming into the United States. The result will be the loss of some 86,000 to 115,000 U.S. jobs or job opportunities.

The impact on supplier industries from the Auto Decree is already manifest for producers of metal castings, wiring harnesses, trim, glass, and a host of other auto components. The most dramatic impact can be seen in new investments for fuel efficient four and six cylinder engines—presumably the mainstay for a modernized American auto industry. Under the requirements of the Mexican Auto Decree, however, North American auto producers have built five of these new, modern, efficient engine plants in Mexico rather than in the United States—even though there was no apparent cost advantage to producing in Mexico. In fact, some 60 to 80 percent of the output of these new engine plants will be shipped back to the United States for assembly into "American" automobiles. (See chart I in appendix.)

Similar requirements exist in Brazil, where, as of 1978, auto producers had given commitments for the export of over $5 billion in automotive products as a precondition for their relatively unrestricted operation in the Brazilian market. U.S. firms had committed to over $2 billion of these automotive exports from Brazil, according to research carried out for the United Nations Center for Transnational Enterprises. (See chart II in appendix.)

Local content requirements on auto imports are mandated by dozens of countries. Under Mexico's Auto Decree of 1977, local content requirements were set initially at 50 percent per vehicle, but were scheduled to rise to 80 percent by 1981. The result of the decree will be reduced sales of U.S. auto parts to Mexico, reduced U.S. sales of vehicles to Mexican free zone areas, and increased shipments of Mexican parts to the U.S. In Brazil, local content requirements are linked with export requirements.

Companies with an export program approved by the Brazilian government are treated more favorably and are allowed a lower percentage of local content requirement. Government-approved programs are allowed percentages ranging from 70 percent to 95 percent for cars, trucks, and other vehicles. Manufacturers without an approved export program are required to manufacture vehicles with a 95 percent local content requirement. Imports of parts and components from Latin American Free-Trade Area nations that assure reciprocal terms to Brazil are treated as being of Brazilian origin as long as they constitute less than 5 percent of value of the content of the vehicle. Brazil's performance requirements discriminate against other developing countries as well as against U.S. investors and exporters.

The direct problem of Japan, of course, demands special attention. While the U.S. maintains an open market to the Japanese, Japan has erected an array of non-tariff barriers to restrict the number of Amerian vehicles that can be sold in Japan. These barriers include commodity taxes, inspection systems, and limits on marketing networks. Such non-tariff barriers can nearly double the price of American cars sold in Japan.

It hardly needs to be restated that the Japanese are not nearly so reticent about automobile exports as they are regarding automobile imports into their country. Japan's global auto exports have risen from 194,000 in 1965 to over six million units in 1982. Indeed, even as U.S. auto producers were falling into depression—such as during the period following the Iranian revolution of 1979—the Japanese continued to expand their sales into this country. In fact, the Japanese industry was operating very high levels of mandatory overtime production, with their overtime output roughly equally the shortfall in American domestic production. Paradoxically, in 1980, just when U.S. unemployment was reaching its worst levels, the Japanese auto manufacturers were announcing further additions to their productive capacity, bringing them to the level of the number one automobile producer in the world.

On the issue of responsible and responsive trade policy in our strongly interdependent world economy, the Japanese have proven to be skillful negotiators whose hallmark is appearing to make concessions while actually giving up nothing at all. When the Japanese were finally brought to accept "voluntary" limits on their exports in the United States in the spring of 1981, they agreed to levels of exports designed according to Japanese industry definitions which resulted in no reduction in Japanese sales to the U.S. market. With the further reduction in auto sales following record high interest rates and the still deepening recession, the Japanese are once again in that favorite position of having their cake and eating it too, with the appearance of export limitations and the reality of strengthened market shares and undamaged profitability.

Japanese purchases of U.S.-made auto parts follow a similar script. In September 1980, a highly publicized Japanese buying mission for auto parts came to the United States to meet with parts industry firms and with all of the concerned unions to express their good intentions to double and triple Japanese purchases of U.S. parts both for original equipment in Japanese cars (particularly for those sold in the United States) and for the burgeoning replacement parts market. The results are instructive: Japanese purchases in 1981 of U.S.-made auto parts actually declined in real terms over 1980 levels. Conversely, during the last decade, the value of U.S. auto parts imports (from countries other than Canada) has risen by 24 percent annually and has been predicted to rise to 30 percent of total U.S. parts sales by 1985 and to 39 percent by 1990. A hard look at the statistics is much more informative than tales of good intentions.

As Deputy Under Secretary of International Affairs in the Department of Labor from 1977 through 1979, I worked with others in the executive branch and Congress to encourage the Japanese to build manufacturing facilities where their markets were—here in the United States. The Japanese government and auto producers continued to receive such encouragement to build here long after 1979. Nevertheless, the largest Japanese auto makers chose to supply the U.S. market by running their Japanese plants on mandatory overtime. Further, they chose to artificially maintain an undervalued yen, now at 260+ yen per dollar, thus gaining an unfair exchange rate advantage of more than 40 percent compared to 1978 exchange rates, and continued to expand their market share in the U.S.

AMERICA'S RESPONSE

It makes no sense for the U.S. to maintain virtually unlimited access to our markets while our access to the markets of other countries is restricted, at a cost of hundreds of thousands of American jobs. We believe that H.R. 5133 addresses this problem in a manner that is equitable both to foreign producers and American consumers. While leaving Japanese producers with full access to the U.S. market, this legislation would aid the American economy by shifting the bulk of the production of those vehicles to American workers and communities. In effect, it would allow consumers to choose which car they want to buy, but would insure at the same time their purchases would benefit the American economy. It would mean well over one million new jobs to the U.S. economy as a whole, including 200,000 auto jobs and 500,000 supplier jobs.

The legislation would prevent American companies from shifting completely to foreign production to supply the domestic market. The bill also addresses the unfair competition faced by U.S. parts suppliers in the replacement parts market, calling in the Secretary of Transportation and the Federal Trade Commission to conduct a one-year investigation on the policies and practices that currently favor foreign-made parts. Based on this information, the Secretary and the Federal Trade Commission will then be able to recommend the appropriate legislation and/or administrative action needed to remedy this problem.

Throughout the debate over H.R. 5133, opponents have claimed higher car prices and a trade war will follow in the wake of the bill's enactment. The spectre of skyrocketing auto prices arises from the misconception that price competition will somewhat vanish. Recent history proves otherwise. Since restraints on Japanese imports began in early 1981, the price of U.S. cars (taking into account the variety of rebate programs available) has risen at the low rate of about 3 percent annually. In contrast, the nation's inflation average has been 8.7 percent. As for the future, price competition should thrive rather than fade as foreign companies such as Honda and Nissan continue to seek a bigger share of the U.S. market . . . but this time, with U.S. built cars.

Opponents of H.R. 5133 also sound the alarm of retaliation and the eruption of a vicious trade war if the bill is adopted. But a look at this legislation in the real life context in which it will operate supports a very different appraisal of the bill's impact. Of the major importers into this country, Volkswagen and AMC/Renault already meet the revised content standards of H.R. 5133; Honda is close behind. In fact, only two companies fall dramatically short of the bill's standards. They are the Japanese firms Toyota and Nissan. Japan, however, has not launched trade wars against the 31 other countries around the world with restrictions on auto imports much stronger than those contained in H.R. 5133, and it is unrealistic to think that the Japanese would retaliate by abandoning the U.S. car market—the largest in the world—or by freezing out the importation of U.S. goods on which Japan now relies. These goods generally represent products which Japan cannot make for itself. Alternative sources for these items are found in countries like Australia, Argentina and Brazil which have in place tighter auto restrictions than those now proposed in H.R. 5133.

Taking these circumstances into account, along with the fact that Japan has been reaping the benefit of an auto trade surplus with the U.S. that amounted to $13 billion in 1981, the likelihood of retaliation from them in minimal. And there is no prospect of retaliation from Europe, whose auto companies are not restricted in any way by the legislation now before the Congress. In short, the issue of retaliation is a red herring.

In summary, we believe that the bill represents a sound and reasonable approach. Indeed, it is critical to the survival of the American auto industry. H.R. 5133 is not designed to introduce a novel or unsettling concept into world trade relationships. It simply realigns the U.S. in a position that is on par with numerous other countries which implemented auto restrictions some time ago. By helping millions of workers keep their jobs, this legislation will greatly strengthen the American economy.

APPENDIX

MEMBERS OF THE COALITION OF AUTOMOTIVE COMPONENT AND SUPPLY WORKERS

Aluminum Workers International Union.

International Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers, and Helpers.

United Brotherhood of Carpenters and Joiners of America.

United Cement, Lime and Gypsum Workers International Union.

International Chemical Workers Union.

Amalgamented Clothing and Textile Workers of America.

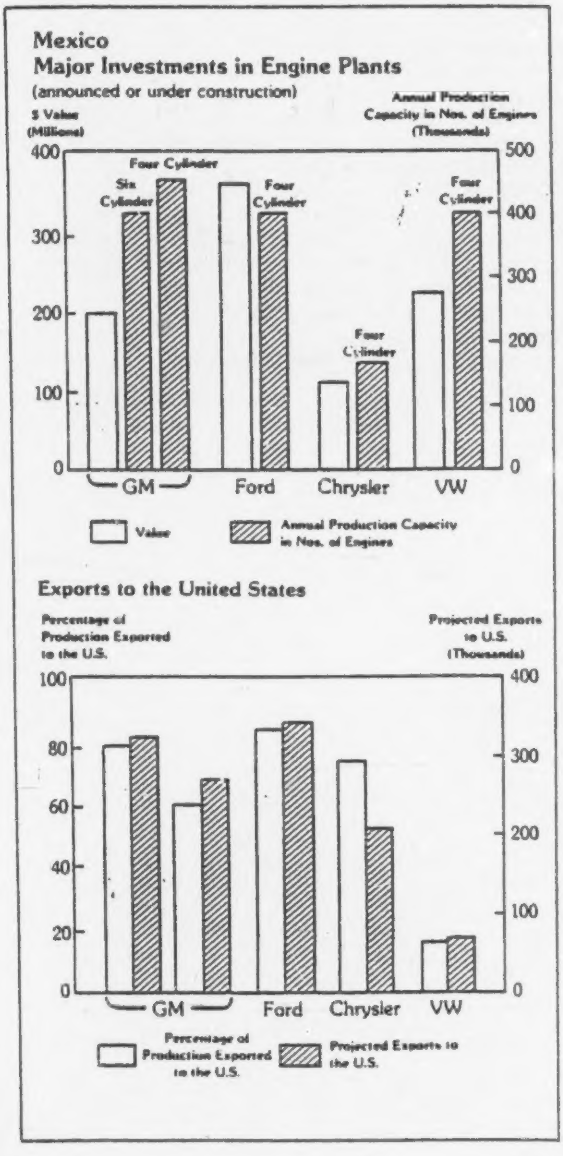
Communications Workers of America.

International Brotherhood of Electrical Workers.

International Union of Electrical, Radio and Machine Workers.

American Flint Glass Workers Union.
United Furniture Workers of America.
United Glass and Ceramic Workers of North America.
Industrial Union Department, AFL-CIO.
Allied Industrial Workers of America.
International Association of Bridge, Structural and Ornamental Ironworkers.
International Association of Machinists and Aerospace Workers.
International Molders and Allied Workers Union.
Mechanics Educational Society of America.
Oil, Chemical and Atomic Workers.
International Brotherhood of Painters and Allied Trades.
United Paperworkers International Union.
Pattern Makers League of North America.
United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry of the United States and Canada.
International Brotherhood of Pottery and Allied Workers.
Retail, Wholesale and Department Store Union.
United Rubber, Cork, Linoleum and Plastic Workers of America.
American Federation of State, County and Municipal Employees.
Service Employees International Union.
Sheetmetal Workers International Association.
United Steelworkers of America.
Upholsterers International Union of North America.

Chart I



Source: "Performance Requirements: A Study of the Incidence and Impact of Trade-Related Performance Requirements, and an Analysis of International Law," Labor-Industry Coalition

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CHART II.—BRAZILIAN BEFIEX AUTOMOTIVE PROGRAM EXPORT AGREEMENTS

[U.S. dollars in millions]

Firm	Export commitment	Period
Ford/Philco	$1,355.4	1974–83
Volkswagen	1,069.0	1974–82
Chrysler	314.5	1974–83
Mercedes Benz	500.0	1975–84
Fiat	550.0	1976–85
Fabrica Nacional De Motores	400.0	1975–84
Saab-Scania	415.4	1976–85
General Motors	1,009.5	1976–86
Total	5,613.8	

Source: Ronald E. Muller and David Moore "Brazilian Bargaining Power Success in BEFIEX Export Promotion Program with the Transnational Automotive Industry," report prepared for the United Nations Centre on Transnational Corporations, New York (Jan., 1978).

Chairman GIBBONS. If I thought this was the last time we were going to be talking about this bill, I would exhaust us. I have a lot of questions I want to ask and I am sure you would be able to answer them. But we have a very limited amount of time here.

Mr. Pease, do you have questions? Mr. Frenzel?

I will get back in touch with you. Thank you very much.

Mr. TURNER. Very good. Thank you.

Mr. FRENZEL. I don't want the witness to think that we are ignoring him, but, as you know, it has been a difficult day with the votes. I would like to review the testimony and we might have some questions.

Mr. TURNER. I will be happy to respond.

Chairman GIBBONS. You have a good statement. I agree with the main thrust of your statement, which is that we need to do something. I just don't think that this is the appropriate remedy.

Mr. PEASE. Mr. Chairman, I just want to add my 2 cents worth also.

It was very good testimony, very valuable, and were it not for the impending vote on the floor, I would be delighted to discuss it with you more.

Mr. TURNER. Let me just take the opportunity, gentlemen, to introduce my colleague, Judy Scott, who joined me in the course of the testimony. She is legislative representative for the industrial union department.

Chairman GIBBONS. Fine. Thank you. I hope next time we can schedule you early in the day so we won't get caught in this.

Mr. TURNER. I hope next time we can appear earlier in the day.

Chairman GIBBONS. This concludes our hearing for this afternoon. We will reconvene tomorrow morning beginning at 9:30 in room B–318 of the Rayburn. I call that to everybody's attention.

Among our witnesses will be Dr. Alice Rivlin, the Director of the Congressional Budget Office, and representatives from the League of Women Voters, the Consumers for World Trade, and the Council for the Advancement of Consumer Policy. We have asked the head of one of the automobile companies to be with us at that time, but we have not received a confirmation from him.

We have received confirmations, though, from the chief executive officers of both Ford Motor Co. and of General Motors Corp. They will be with us either later this week or early next week. With that, the meeting is adjourned for today.

[Whereupon, at 4 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Thursday, September 23, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

THURSDAY, SEPTEMBER 23, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:35 a.m., pursuant to notice, in room B–318, Rayburn House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen. This is a continuation of the hearings by the Subcommittee on Trade on H.R. 5133.

Our first witness this morning is our fine colleague from California, Mr. William E. Dannemeyer.

Mr. Dannemeyer, you may take the chair and proceed as you wish.

STATEMENT OF HON. WILLIAM E. DANNEMEYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Dannemeyer. Thank you, Mr. Chairman. It was my pleasure as a member of the Commerce Committee to hear the testimony——

Chairman Gibbons. Can we get Mr. Dannemeyer a microphone?

Mr. Dannemeyer, we have to tell you we are not used to operating in this room.

[Pause.]

Mr. Dannemeyer. This bill was heard by the Subcommittee of Commerce, Transportation and Tourism in the Commerce Committee. I am not privileged to serve on that subcommittee, but I serve on the full committee. Even on the subcommittee there was only one-half day of hearings with a total of nine witnesses on this particular bill. When the bill was reported out of the Commerce Committee, there were 26 amendments pending at the desk. But the membership adopted an interesting ploy in order to preclude consideration of those amendments, because at 11 o'clock on the day the bill was reported out, by a quorum being present, my peers, bless their hearts, voted to have all proceedings on the bill concluded by 4 o'clock that afternoon. And then for whatever reasons, I have never been able to figure out for sure, my good colleagues honored that commitment by failing to come back for a quorum any time before 4 o'clock—which I suppose is not unusual.

And there were other extenuating circumstances; we had matters on the floor to attend to, so I can't really say it was deliberate.

But we finally came back that evening at about 8:30, I think. The bill was reported out with these amendments pending. I don't believe that there is legitimate reason to push this bill through the Congress in this particular session.

You know, we are all students of history more or less. A little over 50 years ago, precisely 52 years ago, Congress passed a major piece of legislation called the Smoot-Hawley Tariff Act. Those who don't read history and learn from it are doomed to relive it I am afraid. Jude Wanniski, an economist of note today, wrote a book called "The Way the World Works." I want to quote just a portion of what the gentleman said:

> The stock market Crash of 1929 and the Great Depression ensued because of the passage of the Smoot-Hawley Tariff Act of 1930.
>
> On May 5, 1930, 1,028 American economists petitioned Hoover not to sign the tariff bill if and when it was enacted:
>
> Our export trade, in general, would suffer. Countries cannot permanently buy from us unless they are permitted to sell to us and the more we restrict the importation of goods from them by means of even higher tariffs, the more we reduce the possibility of our exporting to them . . .
>
> Many of our citizens have invested their money in foreign enterprises. The Department of Commerce has estimated that such investments, entirely aside from the war debts, amounted to between $12,555,000,000 and $14,555,000,000 on January 1, 1929. These investors, too, would suffer if restrictive duties were to be increased, since such action would make it still more difficult for their foreign debtors to pay them the interest due them.
>
> Hoover signed the bill on June 16, 1930, but the stock market anticipated the act and crashed in the last days of October 1929.

There was an excellent editorial in the Christian Science Monitor of September 16, 1982. Under the heading of "Made-in-America Madness," the editorial begins with this passage:

> Back in the early 1930's, when the world was in the grip of depression, nation after nation slammed shut its doors against overseas imports. Instead, political leaders sought to protect domestic industries, in part by encouraging citizens to "buy American," "buy French," "buy German," and so on. Such policies, of course, worked against the very upturn in world economic conditions sought by everyone concerned.

Then it goes on to say:

> In light of this historical experience, one cannot but be disturbed by the misguided and potentially dangerous trade legislation now working its way through the U.S. House of Representatives—and likely to be passed by that chamber. Called the Fair Practices in Automotive Products Act and sponsored by the United Automobile Workers union, the act is neither fair to consumers nor likely to encourage production of auto parts or stimulate world trade in general.

In my State of California, consumers are buying about 50 percent of automobiles foreign made. And this legislation, if adopted, would increase the cost of those foreign made cars by about 10 percent. Now the League of Nations' World Economic Survey in 1932 and 1933 contains the following passage:

> The Hawley-Smoot tariff in the United States was the signal for an outburst of tariff making activity in other countries, partly at least by way of reprisals. Extensive increases in duties were made almost immediately by Canada, Cuba, Mexico, France, Italy and Spain. During 1930, general tariff increases were announced by India, Peru, Argentina, Brazil, China and Lithuania.

And finally there is information taken from the Tariff Act of 1930, the Smoot-Hawley Tariff Act by Raymond Ahearn, Analyst in

International Trade and Finance, Economics Division, at the Congressional Research Service of the Library of Congress:

> Under the impact of higher tariffs and growing nontariff restrictions, world trade declined precipitously. Between 1929 and 1932 the value of world trade dropped from $66.6 billion to $26.3 billion, while total U.S. trade plunged from $9.5 billion to only $2.9 billion.

I don't think we are kidding anybody. With a decline in trade of that magnitude and consequent reduction in commerce around the world, some historians have observed that it helped sow the seeds of the winds of war in the 1930's. And I just pray that this Nation won't go down the same course.

I might add that one of the amendments that was pending was one that was considered by the committee in another form, the full Commerce Committee, and very narrowly lost, 20 to 21, offered by Mr. Gramm from Texas, our colleague. It would have permitted the President to waive the provisions of the bill if, in his judgment, a nation that produced automobiles had made a good faith effort to reduce trade barriers on the entry of products from this country.

I would hope that perhaps this subcommittee or the full committee would consider a similar amendment, because the closeness of that vote—bear in mind the bill came out of the Commerce Committee 25 to 16, but this amendment was very narrowly defeated 20 to 21, and I think it would give the President the ability to waive the provisions of the act if the Congress sees fit to adopt it.

I don't blame the autoworkers for pushing this bill. The UAW has lost its position in the marketplace of America for a variety of reasons. A study by the Heritage Foundation states that the average automobile worker in this country gets $9.50 per hour in wages. That is what he or she gets versus $7 per hour for the average manufacturing employee. And you can't blame them for trying to recoup what they have lost in the marketplace. They are now coming to Congress and asking us to legislate a preference which the UAW worker enjoys today. You can't blame them for trying. But I don't think we in this institution should be naive enough to permit the UAW to use its political leverage as a means of sandbagging the consumers of this country.

And the Washington Post editorialized on this subject, in part, saying that labor costs, now these are fringe benefits and hourly wages to workers, labor costs including cash wages and all the fringes now average $19.60 per hour among production workers at Chrysler, while Ford and GM are $2.60 an hour higher. These are more than half again higher than the average for all manufacturing workers. This is the killing thing so far as American enterprise is concerned.

CBO has estimated that American manufacturers use about 200 hours of labor to build a subcompact car; the Japanese use 111 hours. The result is a price differential of about $2,000 in the subcompact. That price differential is the main reason why we say today that American car manufacturers are for one reason or another apparently moving out of the production of small or compact cars or subcompact cars. And it is a tragedy for the American worker that this is happening, but it is something I don't believe that Congress should legislate in law to preserve that advantage for UAW workers.

I think the balance of my comments are set forth in my statement, which I would like to file. I want to thank you for the opportunity of coming here and appearing before your subcommittee. If you have any questions, I will be happy to try to answer them.

[The prepared statement follows:]

STATEMENT OF HON. WILLIAM E. DANNEMEYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, and members of the Committee on Ways and Means, Subcommittee on Trade: I appreciate having this opportunity to share my thoughts with you on H.R. 5133, the Fair Practices In Automotive Products Act.

As you know, this bill was reported out of the Committee on Energy and Commerce, on which I am privileged to serve, by a vote of 25-16 on September 15, 1982. It has been sequentially referred to this Committee for a period not to exceed October 1, 1982. You are to be commended for holding prompt and thorough hearings on the legislation at hand.

At the outset, Mr. Chairman, I would like to discuss several procedural matters and questions related to the timing of the legislation. Then I would like to outline the policy-related problems that I have with the legislation. Finally, I would like to share with the subcommittee a series of technical problems which came to my attention as our work on the bill proceeded in the Energy and Commerce Committee.

Unfortunately, only one-half day of hearings with a total of nine witnesses was held by the Energy and Commerce Subcommittee on Commerce, Transportation and Tourism. The bill was reported out of the subcommittee with no amendments after a short mark-up session. When the bill was reported out of the Full Committee, fully twenty-six amendments were pending at the clerk's desk for consideration. And, now, as just noted, the referral time given to this committee has been made very brief indeed.

All of the above is troubling not only on its face, but in light of the fact that the legislation would not take effect until the model year that begins in the Fall of 1983. Under these circumstances, there is no legitimate reason to push this bill through the Energy and Commerce Committee, the Ways and Means Committee, and then through the full House, before the scheduled adjournment of the Congress in early October. This is a serious economic and trade proposal which merits more analysis and consideration than has been the case to date, and will be the case before a Floor vote given the terms of committee consideration of the bill. It is unfortunate that proponents of the bill are pushing it as a cure for the tragic unemployment in the auto industry. All responsible economic analyses question the jobs impact of the bill in the first place, but also predict that any jobs creation or jobs preservation effect will not come for several years. Again, there is no reason, from a policy or legislative standpoint, to prematurely take this bill to the Floor.

THE SMOOT-HAWLEY TARIFF ACT

The pending doemstic content bill is not the first time that the Congress has considered the option of protectionist legislation in response to the economic problems of a domestic economic sector. A similar situation arose in the 1920's with agriculture. The response of the Congress was to raise tariff barriers on the importation of foreign agricultural products through the passage of the Smoot-Hawley Tariff Act of 1930.

The following quotations from The Way The World Works, by economics writer Jude Wanniski, ought to be thought provoking items as we consider H.R. 5133:

"The stock market Crash of 1929 and the Great Depression ensued because of the passage of the Smoot-Hawley Tariff Act of 1930.

"On May 5, 1930, 1,028 American economists petitioned Hoover not to sign the tariff bill if and when it was enacted:

"Our export trade, in general, would suffer. Countries cannot permanently buy from us unless they are permitted to sell to us and the more we restrict the importation of goods from them by means of even higher tariffs, the more we reduce the possibility of our exporting to them. . .

"Many of our citizens have invested their money in foreign enterprises. The Department of Commerce has estimated that such investments, entirely aside from the war debts, amounted to between $12,555,000,000 and $14,555,000,000 on January 1, 1929. These investors, too, would suffer if restrictive duties were to be increased, since such action would make it still more difficult for their foreign debtors to pay them the interest due them.

"Hoover signed the bill on June 16, 1930, but the stock market anticipated the act and crashed in the last days of October, 1929."

Other writers have commented that if the Smoot-Hawley Tariff Act did not cause the Depression, it at least prolonged the economic disaster of the 1930's. It is indeed sobering to note that editorials on H.R. 5133 have also commented on the parallel between the pending bill and the Smoot-Hawley Tariff Act. For example, I would like to bring to the attention of the Subcommittee an excellent editorial in the Christian Science Monitor of September 16, 1982.

Under the heading of "Made-in-America madness", the editorial begins with this passage:

"Back in the early 1930's, when the world was in the grip of depression, nation after nation slammed shut its doors against overseas imports. Instead, political leaders sought to protect domestic industries, in part by encouraging citizens to 'buy American,' 'buy French,' 'buy German,' and so on. Such policies, of course, worked against the very upturn in world economic conditions sought by everyone concerned.

"In light of this historical experience, one cannot but be disturbed by the misguided and potentially dangerous trade legislation now working its way through the U.S. House of Representatives—and likely to be passed by that chamber. Called the Fair Practices in Automotive Products Act and sponsored by the United Automobile Workers union, the act is neither fair to consumers nor likely to encourage production of auto parts or stimulate world trade in general."

Those of us who are concerned about the pending domestic content bill are particularly fearful of foreign retaliation against American exports, a step which is sanctioned by the General Agreement on Tariffs and Trade (GATT). The post-enactment history of Smoot-Hawley should give us a reason to pause and reflect upon the seriousness of the domestic content undertaking and its potential ramifications. The League of Nations' World Economic Survey, 1932–33, contains the following passage:

"The Hawley-Smoot tariff in the United States was the signal for an outburst of tariff making activity in other countries, partly at least by way of reprisals. Extensive increases in duties were made almost immediately by Canada, Cuba, Mexico, France, Italy and Spain. During 1930, general tariff increases were announced by India, Peru, Argentina, Brazil, China and Lithuania."

And, finally, I would point to information taken from "The Tariff Act of 1930: The Smoot-Hawley Tariff" by Raymond Ahearn, Analyst in International Trade and Finance, Economics Division, at the Congressional Research Service of the Library of Congress: "Under the impact of higher tariffs and growing nontariff restrictions, world trade declined precipitously. Between 1929 and 1932 the value of world trade dropped from $66.6 billion to $26.3 billion, while total U.S. trade plunged from $9.5 billion to only $2.9 billion."

At a time when one in five U.S. jobs is export related, and the crops from one in three American farm acres are exported, can we afford to start a trade war? The answer is clearly in the negative, as the Smoot-Hawley experience makes clear.

IS DOMESTIC CONTENT LEGISLATION A SOURCE OF TRADE LEVERAGE?

During the debate on the bill in the Energy and Commerce Committee, many of my colleagues stated that their support for the legislation rested upon deep concerns over the existence of trade barriers to the entry of American products in Japan and other countries. Members expressed the desire to use this legislation as leverage in trade talks and to "hit them with a two-by-four", to borrow a phrase mentioned during committee debate. I am advised that some Members of this subcommittee share the same point of view as that shared by some of my colleagues on the Energy and Commerce Committee in this regard.

I share the feelings of my colleagues on the need for the United States to work towards the lowering of trade barriers around the world, and most certainly in countries such as Japan, which export large volumes of goods to our open marketplace.

However, several areas of this matter must be examined before we take the action contained in H.R. 5133.

There is nothing in the legislation itself which gives our trade negotiators any leverage. If H.R. 5133 is enacted into law, the content requirements and associated provisions take effect in the first model year, the second model year, the third model year, and every year thereafter unless repealed by Congress. There is nothing in the bill to give other nations an incentive to lower their trade barriers. In fact, quite the opposite is true if one stops to consider that the United States has been the leader of the free trade movement for the entire period of the post-World War II era. If we move in a protectionist direction with the passage of H.R. 5133, we cripple our negotiators by undercutting our negotiating position.

The Energy and Commerce Committee had an opportunity to make good on its rhetorical intentions via the consideration of an amendment by Mr. Gramm, which was a variation on an amendment I had also prepared for consideration. The amendment would have allowed the President to waive the content requirements if trade barriers were to be substantially reduced in countries affected by the legislation. The amendment was defeated in our committee by a single vote, 20–21. My amendment, which I was precluded from offering when the previous question on the substitute bill was moved, would have allowed the President to waive the content requirements for a manufacturer whose principal office is in a country which has come to an agreement or understanding with the United States on auto imports.

The inclusion of the Gramm amendment, or my own amendment, or a combination of the two, would then make the text of the legislation conform with the stated intent of the supporters of the bill. The U.S. Trade Representative, as an agent of the President, could then go to Tokyo and other world capitals and be able to state that the President would exercise his waiver power under the domestic content law if the Japanese or other countries would take steps to reduce their trade barriers and/or come to some understanding or agreement on auto imports. Without this provision, the legislation is nothing but an attempt by outside private interests to secure their own narrower objectives by tapping the sentiments of members of Congress on the question of trade barriers.

Even if other countries have trade barriers or domestic content requirements for autos or other products, this does not mean that the U.S. should follow them over such an economic cliff. Domestic content requirements and trade policies of a protectionist nature did not save British Leyland and will not save our own domestic companies. Whether other countries have harmed their consumers and workers is immaterial; we should not so subject our consumers and our workers to the disadvantages of protectionist legislation.

THE DOMESTIC AUTOMOBILE INDUSTRY

In a sense, I do not blame the United Auto Workers (UAW) and their members from pushing for domestic content legislation in order to preserve a wage position via governmental action that would not otherwise hold up in the marketplace. According to a study on domestic content put out by the Heritage Foundation, the average autoworker's wage is 28 percent higher than that of the average manufacturing employee; $9.50 per hour versus $7.00 per hour. This matter was placed in additional perspective in an editorial by the Washington Post under the heading, "Wages at Chrysler." In relevant part, the editorial reads:

"Labor costs, including cash wages and all the fringes, now average $19.60 an hour among production workers at Chrysler, according to the company. They are $2.60 an hour higher at GM and Ford. Those wages are more than half again as high as the average for all American manufacturing workers. In the past, the United Auto Workers justified that tremendous wage differential by citing the high productivity in the automobile factories. But now their grip on the American market is being eroded by competitors whose wages are lower and whose productivity is higher.

"The American manufacturers use about 200 hours of labor to build a subcompact car, the CBO calculated, while the Japanese use 111 hours. The result is a price differential of about $2,000 in a subcompact car—two-thirds of it in the hourly cost of labor, and one-third in productivity."

The editorial ran in the newspaper's edition of September 14, 1982.

The answer to domestic auto troubles is to take internal and external steps to become competitive in world markets, not by attempting to legislate the competition away, thus penalizing other American workers and all American consumers. Congress can help through the pursuit of budgetary policies that will reduce deficits and government borrowing, which in turn will bring interest rates under control. Lower interest rates are a necessary condition, but by no means a sufficient one, for a recovery in the auto industry. The federal government can also be conscious of the state of the domestic auto industry in formulating tax, environmental, and regulatory policies.

In the final analysis, the solution lies in producing a cost competitive car that will sell in the marketplace, where the consumer is the sovereign. My real concern is that the bill as amended and reported by the Energy and Commerce Committee actually works against putting U.S. companies in a position to improve their competitive standing. The bill, as reported, applies different content requirements to U.S.

and foreign manufacturers, which is contrary to the original bill. Under the reported bill, the domestic companies are not allowed to drop below 90 percent of their content ratios for model year 1983. This effectively freezes them at their present content percentage, which is in the range of 90 percent. The effect of this provision will be to preclude, or at least severely restrict, the ability of U.S. companies to secure parts and other components from the least cost source of supply in the world.

The world car is a reality in the automotive industry. Parts are manufactured all over the world. The substitute will deny U.S. companies the access to the world marketplace, where competition will keep prices down, but will not do the same to foreign manufacturers under the terms of the bill. As a result, foreign companies will continue to maintain a price advantage over U.S. companies, which will only work against a rebound in U.S. car sales by domestic companies. Such a provision is counter-productive in the long run, but preserves the UAW's interest in precluding the "out-sourcing" of parts to other countries in the short run.

Labor and management bear the responsibility and face the challenge of auto industry recovery, with government as a willing partner where government action does not conflict with other public policy goals and does not harm non-auto economic interests.

This is being promoted as a jobs bill, and is such a measure. At a time when over 10 million Americans are out of work, and an election is on the horizon, a jobs bill is attractive. I strongly suggest to my colleagues, however, that this is a jobs transfer bill, not a jobs creation or preservation bill. I am advised that 168,000 American jobs alone depend on the importation of automobiles. That statistic includes longshoremen, service and repair personnel at import dealerships, accountants, secretaries, and others affiliated with import manufacturers. All of these people are American citizens, too. By what moral authority or legal right do we in Congress derive the power to take jobs away from some Americans and give them to others simply in response to the organized political pressure of a single group?

The approach embodied in H.R. 5133 is part of the "zero sum" game that plagues all too much of our policymaking today. As we all know, the "zero sum" approach suggests that some must lose in order for others to gain. I reject that approach as cynical, simplistic, hopeless, and just plain wrong-headed. We do not need to declare a trade war, implicitly or explicitly, to accomplish our economic recovery objectives. Protectionist measures such as this one merely export our misery and put it on someone else's doorstep. For the political and economic stability of the world, this is unacceptable. The Congress should step back, avoid a hasty decision, and reformulate an auto policy that is broader and sounder than the one contained in H.R. 5133.

TECHNICAL PROBLEMS WITH THE BILL

As already noted, the bill is ill-timed from a procedural point of view. As a trade policy and as an auto policy, it is clearly inadvisable. Putting these matters aside for a moment, however, raises the question of the technical and mechanical structure of the bill. My own experience in reviewing the legislation and in marking it up in the Energy and Commerce Committee suggests to me that it is also ill-conceived legislation. Please allow me to provide just a few examples.

In the first place, the bill grants the Secretary of Transportation eight new duties by my count, including an investigation into auto replacement parts practices. The Customs Service is given undefined, yet implicitly significant, new duties. Nonetheless, the bill authorizes no new appropriations to carry out the proposed Act. To my knowledge, there was no testimony at the hearing on the bill, or any subsequent communication shared with our committee, on whether the Department of Transportation agrees with this observation that they could administer the law using existing resources. The same holds true for the U.S. Customs Service.

One can also call the workability of the content ratios into question. It is my understanding that the content ratios are to be based upon the number of motor vehicles sold in the United States "during such year." In other words, the domestic content requirement for a given year is based on the number of units sold in the same model year. Yet, as a manufacturer, I would not know the number of units sold for certain until the end of the model year in question. What with the inherent uncertainty of actual consumer demand for car sales, the need for lead time to build in the United States, and the strict content ratios themselves—how can the formula actually work in practice? We will, in short, be penalizing a manufacturer for not meeting a requirement which we do not permit him the time to meet.

The above technical flaw raises a key question, which is an unanswerable one, relating to the penalty section. Our colleague, Mr. Tauke, asked the counsel at the mark-up session what the term "percentage" meant in the penalty section. As you know, a violation of the penalty section results in a reduction in the allowed level of auto imports or auto part imports in the following year in an amount equal to the percentage by which the manufacturer falls short of the content requirement. The example was given of a content requirement of 30 percent where the manufacturer only reaches 20 percent. Is the penalty imposed on the manufacturer the percentage resulting from the difference of 30 minus 20, or a penalty of 10 percent? Or, alternatively, is it 30 minus 20, with the difference of 10 then divided by 30, to achieve a penalty of 33 and one-third percent? This is an important part of the bill if the foreign companies chose not to build in the United States to the extent necessary to maintain current levels of sales. The committee staff counsel answered that under the example the penalty would be 33 and one-third percent. Despite the fact that this ambiguity was raised, neither the reported bill nor the accompanying committee report, clarifies the penalty section.

CONCLUSION

Again, Mr. Chairman, I want to thank you and the members of the subcommittee for giving me this opportunity to share my objections to H.R. 5133 with you. On procedural, policy, and technical grounds, this Congress ought to reject the proposed legislation.

Chairman GIBBONS. Mr. Dannemeyer, I appreciate your coming here. And I know of the fine work you did in the Energy and Commerce Committee to try to bring some sense to this bill. I agree with you, that those who do not read history or understand history are probably forced to relive it. We have one advantage. We are old enough to have lived some of this history. I can remember in my college days, prior to World War II, that we then were discussing in the political science classes and economics classes and the other classes that I was privileged to attend what was causing so much disruption in the world. In those days when you could see it and clearly see what was happening, it was obvious that the political fabric of the world was being torn apart because of the nationalistic economic policies that were beggaring thy neighbor, trying to export unemployment, trying to export nonproductivity, and the same thing is happening today.

This bill, as I have said, is perhaps the worst piece of economic legislation I have seen in 50 years. It is not only the potential for raising the price of cars to all consumers, not on the basis of their choice but on the basis of "if you don't like it take it anyway because that is all you're going to get," and that is dangerous enough philosophy. But it signals to every other industry in America, "Well, if you can get your political muscle up big enough you can do the same thing. You are entitled to it." There are a lot of other industries more affected by competitive goods than autos.

Then you look at this industry with the highest paid management in the world, you would think it is the most skilled management to receive that pay; the second highest paid labor in the world, you would think it would be the most productive labor in the world, now coming to Congress asking us to protect them from fair competition. Fair competition because they have brought cases in the Tribunals of the United States and never been able to prove unfair competition. And saying, "We are living like kings, support us like kings, you peasants." That is exactly what they are saying to all the rest of us in this country.

We can't make it on our own, but by political muscle you are going to give it to us. That is all this is, pure, naked economic aggression against every other working American. It has to be the most selfish piece of legislation I have ever seen by people who are well educated and highly endowed and highly blessed by this country. I can understand the unemployment situation. Certainly, it is a terrible thing. But this is not the solution to it. We are told by people, and it is unrefuted testimony so far, it will cost $100,000 per job to be saved in this industry—$100,000. Why at that rate you could go out and buy 10 cars, 10 pretty good cars from American assembly lines. And you could give them away to all the poor people in the United States and you wouldn't do nearly as much damage to the economy. That would be another ridiculous solution to the problem.

But you never could get Congress to vote the $6 billion that this thing would cost the first year and every year thereafter just to support the highest paid people in the country. Why, you know, they would think we were nuts if we did that. But we could do it by indirection and by coercion and by what I really call the kind of Mussolini state socialism that was promoted in the 1930's in Italy.

We have people who never studied history, never understood history saying that to us today. That is what this issue is all about. I pull no punches. I mean every word I say.

Mr. DANNEMEYER. I represent the UAW would have to put you down as doubtful, Mr. Chairman.

Chairman GIBBONS. I think you have done a good job in pointing out the problem we have here. I commend you for it. I back you for it. I am for protecting American jobs but I want to protect every American job.

Mr. DANNEMEYER. Let me tell you the reason I became really alerted to th[illegible] don't have a lot of UAW workers in my district. I suppose th[illegible]ious. But I do have a lot of people that are engaged in [illegible] industry, electronics, and so on, in California. The con[illegible]ur State, as I mentioned, we buy by choice, almost half [illegible] sold in the State are foreign made. It is for those people [illegible] taken an interest in this matter and tried to point out [illegible]leagues just the tremendous problems with the legislation.

I thank you.

Chairman GIBBONS. Mr. Brodhead?

Mr. BRODHEAD. I have no questions, Mr. Chairman.

Chairman GIBBONS. Mr. Bailey?

Mr. BAILEY. Thank you, Mr. Chairman, very much.

When the chairman was making his statement, Mr. Dannemeyer, I was very interested in the comments you made because I happen to agree with him, that whenever you deal with an issue like this you certainly should be knowledgeable of a little bit of history. I am proud of the general reading that I have done and the depth of my knowledge that I would like to compare it with anybody, and I have done a little reading. And for example, here or there you hear the contention that free trade perhaps was the catalyst or the vehicle by which, for example, the world was rebuilt following the Second World War. Of course, anyone who has a real knowledge of history and has done any real homework really knows that the way in which Europe was rebuilt and Japan was rebuilt was essentially a plan which provided for very, very protectionist measures to get those economies on their feet, to get them functioning and to provide for the export of capital and technology and all forms of assistance from the United States to those cities to get them on their feet and to make them democratic.

That means you have to be flexible. You have to be a little bit pragmatic. You cannot deal in international relations or in economic issues or in trade or domestic policy in terms of platitudes and simplistic categorical classifications of great concepts which, of course, have to vary. For example, let's talk about the vehicle industry. Now you and I are very strong supporters of the need for a strong defense in this country. And you would say to me, of course, when it really got down to the wire, that to some degree or another probably a vehicle industry is needed. Now I am not implying that if we don't pass this legislation that it will die away. But it doesn't point up the fact that one of the things we should think about is the Nation's industrial base and some of the general problems.

Or if we talk about a statement you made on page 8, I will read it to you from your statement: "The American manufacturers use about $200 of labor to build a subcompact car. The CBO calculated——"

Chairman GIBBONS. That is hours of labor. You said dollars.

Mr. BAILEY. I am grateful. I thank the chairman for the correction. I am very grateful he is listening that closely to what I say.

"The American manufacturers use about 200 hours of labor to build a subcompact car * * *," I assure the chairman my mistake wasn't deliberate. "* * * the CBO calculated, while the Japanese use 111 hours. The result is a price differential of about $2,000 * * * " I think it is very unfortunate that this concept, and I disagree with my chairman here, a man I very much respect, but I think the discussion on this thing in terms of a criticism of American labor or union strength or power is disserving the issue and I don't think is serving the country very well.

I have done a study, in fact I directly interviewed managers of the automobile industry as to whether or not they have faced resistance of the UAW on modernization. Those productivity implications in that paragraph you made I would be happy to accept, very, very happy to accept. But I want to make it very clear, and I think it should go on the public record, that America's major industrial unions have not been productivity fighters. That has not been their policy. They have not been featherbedders. And it is very, very important to make that point.

What that means is that when we consider a piece of legislation like this we have got to go to some of the root causes. I disagree with the gentleman, incidentally, and I disagree basically with what he has said on page 7. It says, "Even if other countries have trade barriers or domestic content requirements for autos or other products, this does not mean that the United States should follow them over such an economic cliff."

Mr. Dannemeyer, if they are going over an economic cliff by virtue of what they are doing, they can only be doing so in light of American reaction to pushing them, because if we continue to do nothing, they are going to be nowhere near the edge of the precipice. We are being used, in short. I would like to know what you would suggest we do. Would you like us to structure our domestic policy the way the Japanese have structured their governmental and industry and union relationships? Do you want us to do that? Do you want us to structure the relationship between Government and private enterprise the way, for example, the French do? How did you vote on the Export-Import Bank?

I don't know. But you see——

Mr. **Dannemeyer**. I voted to cut its funding. I got a lot of heat for it, too.

Mr. **Bailey**. Well, I knew that, you see. But the thing is, I just wonder what you would suggest we do because we are not going to be able to maintain this great free enterprise model that you and I both believe in. At some point, to paraphrase an advertising campaign, the rubber is going to meet the road. What would you have us do? What should we do as a country? We have been negotiating this thing for countless years. What do you want us to do?

I don't like this legislation in an ideal situation, Mr. Dannemeyer. Can we have some capsulated recommendations, if there are any?

Mr. **Dannemeyer**. Well, you know, in response to your question, which is a good one, I would have to relate to you a philosophical bias.

Mr. **Bailey**. I share a philosophical bias.

Mr. **Dannemeyer**. One of them is that what we do here in the Congress of the United States is very important to the political destiny of our country and to the economy.

Mr. **Bailey**. Absolutely.

Mr. **Dannemeyer**. But you know, we cannot, even if we wanted to, legislate the repeal of the law of supply and demand. We cannot legislate even if we wanted to the imposition of judgment on any human being. We cannot legislate for or against those fundamental concepts of the market system that operate——

Mr. **Bailey**. In the ideal world.

Mr. **Dannemeyer**. In the world.

Mr. **Bailey**. In the ideal world.

Mr. **Dannemeyer**. Even in your words, in the ideal world. In other words, the market system if left alone is going to resolve this problem of difference in productivity of production of motor vehicles and difference of wage differential in this country. If capital in this country wants to stay in the automobile industry, it is going to have to get competitive with its competitors.

Mr. **Bailey**. Capital? I am glad you said that. Do you agree with the contention I made about the unions and productivity?

Mr. **Dannemeyer**. Listen, there is enough blame to go around.

Mr. **Bailey**. I agree. I am glad to hear you say that.

Mr. **Dannemeyer**. Management in the automobile industry, in my humble opinion, has got some good explanations to come forth with to explain its stewardship in the decade of the 1970's.

Mr. **Bailey**. What about Government?

Mr. **Dannemeyer**. Well, we, I think, if you ask me, the Congress of the United States has its share of blame to come in for when we, for good motives back in the early 1970's, protected our consumers from the true price of gasoline by putting a maximum price below the market. When we put price controls on oil in this Nation in the early 1970's we helped create the debacle that now exists because we formed consumer attitudes toward automobiles by giving our consumers the idea that better mileage was not necessarily in their interest, in their economic interest.

Mr. BAILEY. I agree so completely with what you have said; you know I couldn't take issue with it. The point is we have come to this point in time. We have got a very badly undercapitalized automobile industry, partly because, I think, of our tax laws, partly because of our regulatory structure, partly because of our failure as a government, for example, to fight for that free trade that you and I believe in when it comes to that ideal model of free enterprise.

For example, we just simply didn't go out there and push to equalize because Big Daddy here was in the business of exporting diplomatic and military advantages, and using trade in that context, and our economy as the sponge to try to gain those advantages with foreign governments. All of a sudden we have awakened here to a different world. A world of strong, powerful economies beyond our shores that follow different practices than we do. Now, the question is what do we do about it to preserve that thing that you and I both agree to? Is there a new thing, a thing called state monopolies maybe that are arising in the world? I don't know. How do we react to them? What do we do? I am just searching for the solution.

Mr. DANNEMEYER. In the automobile industry, I say that the market system will work its way of resolving the impasse if we permit it to do so. This Nation has severe trade problems with Japan, I admit that. Japan has asserted a trade barrier for importation of citrus from California, for much of our electronic products. Frankly, we don't like it. But I don't believe that the solution to that challenge, that dilemma, is for Congress to put into place a law that is very difficult to change. I don't mind giving our trade negotiators some leverage for trade bargaining purposes, which is the way I think this problem should be handled with the Japanese.

Mr. BAILEY. Bill, should we just wait them out? Is the market going to operate that way?

Mr. DANNEMEYER. For the automobile industry I think it will.

Mr. BAILEY. We should just wait them out?

Mr. DANNEMEYER. Yes, I think so.

Mr. BAILEY. Well, I think we tried to do that and maintain this Nation's defense base which is based on this industrial base, and I think it is a very dangerous gamble. It is a very high stake in a very low hand. I think it would be dangerous. I don't think we can write policy that way. I think we are going to have to get tough.

Mr. DANNEMEYER. I think on the trade problem our negotiator should. If I had my druthers of a better world, it would be helpful to the development of the competitiveness of American automobile manufacturers if we could structure our trade unionism similar to what Japanese do. In Japan, the loyalty of the worker is to the company. In America the loyalty of the worker is to his union. And that develops different attitudes and loyalties that is inimical to the best bargaining position, competitive position of companies in this country. We have developed that way. I am not sure we can change it. But I recognize the need for strong unions in the country.

Mr. BAILEY. Well, we disagree. Maybe if we wait long enough the Japanese unions will do what our unions have.

Mr. DANNEMEYER. Thank you.

Chairman GIBBONS. Mr. Pease?

Mr. PEASE. Thank you, Mr. Chairman. I just was intrigued by one thing in your testimony, Bill. At page 3 you quote Jude Wanniski, an economics writer, about the Smoot-Hawley tariff. He says that the stock market crash of 1929 ensued because of the passage of the Smoot-Hawley Tariff Act of 1930.

Mr. DANNEMEYER. Right.

Mr. PEASE. That certainly is intriguing. How did that come about that the crash came a year before the Smoot-Hawley Tariff Act was passed?

Mr. DANNEMEYER. Maybe you should ask Mr. Wanniski, but I think he says in his bottom quote there on page 3, the stock market as we all know is a compilation of the investment judgment of the most astute people of our country. That is why they are there, that is why they get paid, because of their judgment. And the market, it is said, anticipates economic conditions by at least preceding what really happens by 6 months. In other words, the market anticipates. It makes judgments as to what is going to happen.

This recent stock market increase of last month anticipates what the market will reflect may happen next spring in terms of the economy of the country. And I think that is the rationale for it. I admit it does puzzle one, how could something, if Congress adopts it in 1930, how can that explain the crash of 1929. And Wanniski's rationale is that the stock market anticipated the adoption by Congress, because you know, that bill did not just—it was not introduced one day and adopted the next. It was, you know, preceded by a long campaign.

I predict this bill is not going to get out of this Congress, but it is going to come up again next year, and so on, until we finally figure out some way out of this morass.

Mr. PEASE. Does that mean then that the recent upturn in the stock market means that 6 months or a year down the road the economic recovery program may actually start to work?

Mr. DANNEMEYER. The economic recovery program of this country will begin to work when this institution in which we are privileged to work will assert the discipline to make the outgo consistent with the income by reducing the tremendous red ink we are foisting not only upon ourselves but our children, our grandchildren and our great grandchildren. It is totally and completely irresponsible, what we are doing to the people of this country collectively as an institution.

Mr. PEASE. Would you include the President in that irresponsibility?

Mr. DANNEMEYER. There is enough blame to go around for all of us.

Mr. PEASE. Thank you.

Chairman GIBBONS. We will recess now, and immediately after this vote we will go to Mrs. Rivlin.

Mr. DANNEMEYER. Thank you, Mr. Chairman.

[Recess.]

Chairman GIBBONS. Dr. Rivlin, Director of the Congressional Budget Office.

We are glad to have you and your staff here today. You may proceed as you wish.

STATEMENT OF ALICE M. RIVLIN, PH. D., DIRECTOR, CONGRESSIONAL BUDGET OFFICE, ACCOMPANIED BY LLOYD ATKINSON, PH. D., DEPUTY ASSISTANT DIRECTOR, FISCAL ANALYSIS DIVISION; DAMIAN KULASH, PH. D., DEPUTY ASSISTANT DIRECTOR, NATURAL RESOURCES AND COMMERCE DIVISION

Ms. **Rivlin**. Thank you, Mr. Chairman. Let me introduce Dr. Lloyd Atkinson from our Fiscal Analysis Division, and on my left, Dr. Damian Kulash, who runs the transportation analysis unit of our Natural Resources and Commerce Division.

Mr. Chairman, the Fair Practices in Automotive Products Act, H.R. 5133, is designed to reverse deteriorating employment conditions in the U.S. automotive industry. The Congressional Budget Office's analysis of the bill concludes, however, that while H.R. 5133 would stimulate employment in the auto industry, this benefit would be more than offset by reductions in United States and world employment and output.

CURRENT EMPLOYMENT CONDITIONS IN THE U.S. AUTO INDUSTRY

As no one needs to remind the subcommittee, the U.S. automotive industry is currently experiencing one of its worst slumps in U.S. postwar history. This is manifested both in the very depressed levels of automotive production and sales registered during the first 8 months of 1982, and in the extremely high rate of unemployment among workers in auto and auto-related industries. Statistics documenting this decline have been recurring news since late 1978. Employment in auto manufacturing has fallen dramatically since then—from a peak of more than 762,000 production workers in December 1978 to fewer than 482,000 workers in June 1982—a drop of nearly 40 percent in less than 4 years. As of mid-September 1982, nearly one-quarter million auto workers were on indefinite layoff.

A variety of causes underlie the unemployment among U.S. auto workers. Slow economic growth, recession, and record high interest rates have been the dominant factors suppressing levels of domestic auto production in recent years. The displacement of domestic car sales by increased imports, as the U.S. market swung from standard-size toward subcompact models, has also resulted in additional job losses among U.S. automakers. Finally, both productivity improvements and increased offshore sourcing of auto components, as domestic manufacturers attempted to respond to heightened foreign competition, also slowed domestic auto employment growth.

The increased market share captured by foreign auto producers is the source of heated debate. Over the past decade, foreign auto manufacturers have nearly doubled their share of the U.S. passenger car market—from 15 percent in 1971 to 27 percent in 1981. Since 1981, sales of both imported and domestic cars have fallen off as a result of the recession and high rates of interest. But while the volume of import sales has been dropping, import penetration of the U.S. new car market continued to rise throughout 1981 and thus far in 1982. Last month, imports accounted for a record 32.7 pecent of the United States new car market.

A complete economic recovery from the current recession, in combination with a substantial restoration of past market shares, would still not cause U.S. automotive employment to rebound to the peak levels of 1978. Introduction of more efficient plant and processes in the automotive industry, together with a shift toward smaller cars, will ultimately mean lower levels of automotive industry employment. Many of the layoffs recorded in current statistics represent permanent job losses.

THE MECHANICS OF H.R. 5133 AND THEIR EFFECTS

H.R. 5133 would attempt to restore U.S. autoindustry jobs by instituting minimum domestic content requirements for passenger vehicles and light trucks sold in the United States beginning with model year 1984. The domestic content requirements—defined as U.S. value added as a percentage of the wholesale price—would have to be met by each foreign or domestic auto manufacturer producing more than 100,000 units for sale in the U.S. market. Once fully phased in, these requirements would be graduated, from 10 to 90 percent, as the volume of vehicles sold by each manufacturer increased.

According to the CBO's estimates, a minimum of 15 percent of the wholesale value of an imported car would qualify as domestic content by 1990, most of this representing expenditures made by foreign manufacturers in the United States for advertising, transportation, raw materials, and accessories. The domestic content of foreign-produced autos could be increased by another 10 percent relatively easily, by foreign automakers' purchasing additional U.S.-built components. Thus, domestic content of around 25 percent as defined in H.R. 5133 would be fairly easy for foreign automakers to achieve by 1990. According to the provisions of the bill, this would mean that each foreign auto producer could export 250,000 units per year without establishing production facilities in the United States on a large scale. To maintain their U.S. market shares, however, the four large-volume Japanese auto producers—Toyota, Nissan, Honda, and Toyo Kogyo (Mazda)—would need to consider relocating a significant proportion of their production to the United States. Honda and Toyo Kogyo could probably meet their required levels without much difficulty, since Honda has already built production facilities in the United States, and since the domestic content required for Toyo Kogyo would be only slightly above the easily achievable levels. The key uncertainty surrounds the probably response of Toyota and Nissan.

It seems unlikely that Toyota and Nissan would shift sizable amounts of their production facilities to the United States, because these firms would probably suffer the loss of their current cost advantages. Accordingly, the practical effect of the bill for these producers would be the imposition of an import quota. The CBO analysis assumes that, by 1990, Toyota and Nissan would each be forced to limit their exports of autos to the United States to about 250,000 units.

ECONOMIC COSTS OF TRADE RESTRAINTS

Like any form of restrictive trade legislation, H.R. 5133 would reduce U.S. national income and redistribute the smaller amount of income in favor of the beneficiaries of the restriction—namely, the auto industry. The bill would undoubtedly stimulate production and employment in U.S. auto and auto-related industries. But these benefits for the automotive industry can occur only by making other sectors of the economy and consumers worse off.

Even if Japan—the principal country affected by this bill—did not institute retaliatory restrictive trade actions, the U.S. economy as a whole stands to suffer a net loss. In the current economic environment, however, such legislation might produce some positive results. These would be only temporary, however, not permanent; they would occur only because the economy is now experiencing considerable slack. In a more fully employed economy, the overall effects of H.R. 5133 would be decidedly negative: employment and output gains in the U.S. auto industry would be made possible only by shifts of resources from employment elsewhere in the economy. The consequent inefficiencies entailed by these shifts of resources, in combination with higher inflation, mean that real output would be lower than otherwise. Moreover, import restrictions are not an efficient means of achieving the goal of high employment. This objective is better achieved with fewer risks by conventional monetary and fiscal policies.

In the more likely event of Japanese retaliation against U.S. auto import restrictions, the net effects of H.R. 5133 on the economy as a whole would be even worse. Any benefits that would accrue to the U.S. automotive industry would be more than offset by losses imposed on the rest of the economy.

The potential risks inherent in H.R. 5133 go well beyond the apparent negative effects on the U.S. economy. Plainly put, H.R. 5133 constitutes a direct threat to the unfettered trading order that has been the keystone of U.S. foreign economic policy for some 20 years. The United States has pioneered in the dismantling of impediments to the free international flow of goods and services. Adoption of H.R. 5133 would represent a backward step—and perhaps a regrettable precedent—in this progressive movement. A likely result would be counterproductive trade wars. Under these circumstances, hard-won advantages for the United States and its trading partners derived from a liberal trading order would be lost.

COST ESTIMATES OF THE ECONOMIC EFFECTS OF H.R. 5133

By restricting imports of passenger vehicles and light trucks, the domestic content requirement legislation would have a significant and direct effect on output and employment in the U.S. automotive and related industries. Assuming that domestic sales of new cars return to earlier trend rates, and that all foreign auto producers, other than Toyota and Nissan, increase their sales volumes at rates that maintain 1981 U.S. market shares, H.R. 5133 would have the effect of reducing auto imports to the United States to about 2.6 million units by 1990—approximately 70 percent of the 3.75 million units that might otherwise have been imported in that year. By 1990, the displacement of 1.1 million foreign cars would force vehicle prices up—by an average of about $333 per unit—an outcome that would promote additional domestic production by, in effect, levying a heavy tax on U.S. auto buyers. In response to higher auto prices, sales of automobiles would be dampened. As a result, U.S.-built vehicle sales would rise by only 623,000 units, in contrast to the displacement of 1.1 million foreign cars.

[A table follows:]

TABLE 1.—SUMMARY OF ECONOMIC EFFECTS OF DOMESTIC CONTENT LEGISLATION BY 1990 (H.R. 5133 AS REPORTED SEPT. 16, 1982)

	Under current policy	Under H.R. 5133	Change resulting from H.R. 5133
Sales of new cars and light trucks (in thousands):			
Domestic	11,250	11,873	+623
Imported	3,750	2,603	−1,147
Total	15,000	14,476	−524
Average price of cars and light trucks (in 1982 dollars)	8,850	9,183	+333
Employment effects (in thousands of workers):			
Automobile manufacturing	803	841	+38
Auto-related industries	1,887	1,956	+69
Non-auto-related industries	112,444	112,271	−173
Total	115,134	115,068	−66
Real gross national product (in billions of 1972 dollars)	1,923.2	1,921.3	[1] −0.1
Consumer Price Index (1972=100)	486.4	487.4	[1] +0.2
Unemployment rate (in percent)	6.5	6.6	+0.1

[1] In percent.

Source: Congressional Budget Office.

Ms. RIVLIN. Corresponding to this increase in domestic auto production, the CBO's results suggest that direct employment in auto manufacturing would rise by about 38,000 jobs more than otherwise by 1990; employment in auto-related industries would rise by 69,000 jobs more than otherwise.

Despite these benefits to the U.S. automotive industry, the CBO's analysis implies that the net effects for the U.S. economy—measured in terms of real economic growth, inflation, and employment—would be negative. The benefits accruing to the U.S. automotive industry would be more than outweighed by the costs borne by the rest of the economy.

The principal reason why legislation such as H.R. 5133 would adversely affect the performance of the U.S. economy overall has to do with the fact that the implied restrictions on auto imports would invite retaliatory trade measures—in this instance, on the part of Japan. Assuming equivalent retaliatory trade restrictions on U.S. exports to Japan, the CBO results show that by 1990 the U.S. price level would be about 0.2 percent higher, real gross national product about [GNP] 0.1 percent lower, and the overall unemployment rate 0.1 percentage points higher than otherwise. The gain of 107,000 jobs in auto and auto-related industries would be countered by the elimination of 173,000 jobs caused by retaliatory measures. This asymmetric employment response, indicating that the number of jobs lost through restrictions on U.S. exports exceeds the number of jobs created because of reduced auto imports, is consistent with the fact that U.S. export industries are more labor- and skill-intensive than U.S. auto and auto-related industries. In light of the importance to Japan of her auto industry, and the current depressed condition of the world economy in general, it seems reasonable to assume that significant retaliatory steps would be taken. Since this response is sanctioned by articles XI and XXIII of the General Agreement on Tariffs and Trade, [GATT] retaliation seems to be all the more likely.

CONCLUSION

In sum, Mr. Chairman, the CBO concludes that, although H.R. 5133 would stimulate production and employment in U.S. auto and auto-related industries, it would do so only by imposing large costs on the rest of the economy. In the unlikely event that Japan refrains from retaliation, H.R. 5133 would, at best, provide only a temporary stimulus to overall output and employment. Its long-term effect would be negative, any positive effects for the U.S. automotive industry being more than nullified by the losses endured by other sectors of the economy. In the far more likely case of Japanese retaliation, the negative effects of H.R. 5133 on the economy as a whole would be markedly worse.

The CBO concludes that H.R. 5133 is a poor tool to achieve the objective of high U.S. employment. It invites foreign trade retaliation, and it runs counter to the longstanding U.S. objective of promoting open and free trade. Accordingly, it risks reigniting trade restrictions worldwide, which, past experience has shown, can have disastrous effects on both the U.S. economy and the global economy generally.

Trade is no longer a relatively small part of the U.S. economy. Indeed, imports and exports each constitute more than 12 percent of our current GNP. Using import restrictions to assist beleaguered import-competing industries like autos can boomerang and adversely affect U.S. export industries.

Chairman GIBBONS. Let me say at the beginning, you have done the same type of job I have seen you do many times before. That is to calmly and dispassionately analyze the situation. I say this not only because I support your conclusion, but I think you have been very restrained in your estimates and have tried to do a very top-notch, professional job. In sum and substance, as I read your conclusions, this bill is just not good for America. I know you do not engage in political prognostication, but let me engage in a little of it.

If we take the highest paid management in the world and the second highest paid labor in the world, and say, "We slaves are going to support you because you have the political clout to make us do it, to intimidate us into doing it," what are we going to say to all the other people who are not doing so well, and whose wages are more competitive with other wages in this country and whose management is hustling? How are we going to ever stop them from coming here and saying, as a matter of justice and equity, "You have taken care of the richest, why can't you take care of some of the deserving, real victims of failures of our society?"

What would happen to our economy if we started down that road? Would our economy become very inefficient? Would it mean that our whole standard of living would slip? What would happen in that scenario?

Ms. RIVLIN. That is the danger that I see arising from inviting competitive trade restrictions around the world. The situation in the automobile industry is very serious, and I certainly don't want to be read on this as downplaying it. It is a very serious situation, indeed.

Chairman GIBBONS. Most cases of suicide are serious. This looks like almost one that was self-induced. That is my editorializing, not yours.

Ms. RIVLIN. No, the situation has certainly resulted from a combination of events. But it has been a very bad combination for anybody associated with the automobile industry. The danger in going the route laid out in H.R. 5133 is, I think, the one you suggest. Not only would there be efforts to protect other industries that are suffering from import competition—and there are others—but there would also be foreign retaliation. Things would go back and forth in a situation in which everybody loses.

Chairman GIBBONS. Well, you know, the other day, a number of our witnesses brought out this point. That in the last few years, I think since 1978, domestic consumption of cars, domestically produced cars, has decreased by 4.5 million units, while at the same time the increase of foreign penetration has been only about 450,000 units. Now by simple mathematics we have obviously lost a lot more domestic consumption because people are just refusing to buy the product. They can't afford them, they are priced out of their range. Or they have changed their buying habits.

In your opinion is the principal problem of the automobile industry foreign imports, or is the principal problem of the automobile industry themselves? Or is it some other problem?

Ms. RIVLIN. It has really been two things: the shift in market demand for smaller cars, in which the imports were more competitive, and the recession cutting the demand for all cars. The net effect has been a double whammy for the industry.

Chairman GIBBONS. In your opinion, though, as I recall, should a miracle occur and the industry regain its former share of the American market there still will probably not be the employment, there still will probably not be the profitability in it as there has been in the past. Is that a correct conclusion?

Ms. RIVLIN. Getting back to a healthier economy would certainly help a lot. But realistically, if the American automobile industry is going to compete successfully in the world, it will do so by shifting more to smaller cars, which don't take as much employment and by increasing productivity substantially. This is another way of saying not using as many hours per car.

Chairman GIBBONS. I don't know whether you and your staff have looked at this phenomenon but there has been a bump in our society caused by the postwar baby boom ever since the 1950's that first revealed itself in the growing of the diaper industry and then the crowding of our public school systems, and double sessions and things of that sort. Then right on through and finally the bump hit the colleges, and then it began to drop off there. I imagine it hit the homebuilding industry and it hit the automobile industry. And from a democratic point of view, it doesn't look like we are going to have another of those bumps in our economy and society for a long time.

To what extent did that bump play in the impact upon this industry?

[Pause.]

Ms. RIVLIN. The baby boom generation already owns cars, by and large.

Chairman GIBBONS. They are trying to get housing now.

Ms. RIVLIN. They are trying to get houses now. They do not all own houses now, so if interest rates come down, the prospect for a pickup in the housing market is very substantial. But most of them own cars. That is another factor that would lead you to think that, as you look ahead, the demand for cars will be mainly a replacement demand. There isn't a prospect of a large new demand.

Chairman GIBBONS. Is there any evidence that—you know I hate to use the word planned obsolescence, because I really don't think that they conspired to have the cars wear out as fast as they did, as fast as they convinced us they did anyway. Is there any evidence that there has been a change in buying habits of Americans in keeping their car longer and using it longer?

Ms. RIVLIN. Yes, there is. It is not clear whether that is permanent or not. At the moment, Americans are keeping cars a long time, longer than they used to. My own guess would be that this trend is partly permanent. We have adjusted from the time when a new car was a status symbol, and nearly everybody replaced their cars very frequently. But that is just a guess. The facts are right now that people are keeping their cars longer. Whether that is because of the recession, because they are driving less, because of the higher price of gasoline is hard to say. But it is the fact of the moment.

Chairman GIBBONS. Speaking only for myself, I can't afford them. So I am just keeping the old one.

Mr. Bailey?

Mr. BAILEY. Thank you very much, Mr. Chairman.

Ms. Rivlin, how are you?

Ms. RIVLIN. Just fine.

Mr. BAILEY. Good. Ms. Rivlin, I noticed you were sitting in the audience when Mr. Dannemeyer, our colleague from California, spoke. I would refer you and your staff to a paragraph, page 8, of his statement. Let me know if this is correct information:

> The American manufacturers use about 200 hours of labor to build a subcompact car, the CBO calculated, while the Japanese use 111 hours. The result is a price differential of about $2,000 in a subcompact car, two-thirds of it in the hourly cost of labor and one-third in productivity.

Are those figures substantially correct? Are those your figures?

Ms. RIVLIN. Yes, those come out of our study.

Mr. BAILEY. What would happen to the price of American subcompact cars relative to the price, and you may not have it, to the current market prices of comparable Japanese products if the Americans used 111 hours to produce that car? Do you know? Do you have that information?

Ms. **Rivlin**. Maybe one of my colleagues can do the arithmetic quickly. It would be substantially less.

[The following was subsequently received:]

The attached table illustrates this point.

ILLUSTRATION OF JAPANESE COST ADVANTAGE IN THE MANUFACTURING OF SUBCOMPACT CARS, ASSUMING IDENTICAL PRODUCTIVITY IN JAPAN AND THE UNITED STATES

Total advantage	Hours per subcompact car	Compensation per hour (in dollars)	Labor cost per car
Japan:			
Automobile manufacturers	53	7.74	410
Suppliers, materials, etc	58	6.23	361
Total	111		771
U.S.A. (assuming Japanese productivity):			
Automobile manufacturers	53	17.55	930
Suppliers, materials, etc	58	11.06	641
Total	111		1,571
Difference in labor cost per car			800
Transportation and customs duties			[1] 400
Yen devaluation since 1981			500
Total Japanese cost advantage			900

[1] Provisional estimates.

Source: CBO computation based upon wage rates reported by Bureau of Labor Statistics, "Hourly Compensation for Production Workers in Motor Vehicles and Equipment Manufacturing: 1981".

Mr. **Bailey**. If you then did something with the end, which you have not mentioned in the value of the end, do you have any way of calculating what the impact would be on market prices in the United States today? My question is very simple. It is if productivity were equal, the automobiles were produced with a similar number of man-hours of labor, and of course I don't want to be unfair to you because there are other incidental costs, debt service and everything else. I don't want to be unfair to you. But all things being equal, if we could assume we didn't have a debt service cost, investments had been made, technology was in place and we were producing those automobiles with 111 hours of work, how competitive would the American products be given the fact that in this paragraph quite obviously labor standards and wage rates are taken into account? Do you know the answer to that question?

Ms. **Rivlin**. Well, just on the productivity side, it would reduce the price difference between Japanese and American cars, just using those rough calculations, by around $900.

Mr. **Bailey**. This says here there is a differential of $2,000.

Ms. **Rivlin**. That is right. More of it is accounted for by the wage differential than by the productivity differential, but they are both substantial.

Mr. **Bailey**. $900 difference. What are the differences now? Do you know?

Ms. **Rivlin**. For the total difference, we are estimating around $2,000.

Mr. **Bailey**. Those figures are correct, then?

Ms. **Rivlin**. They are estimates.

Mr. **Bailey**. Well, as nearly as you can ascertain?

Ms. **Rivlin**. They are as good as we can do.

Mr. **Bailey**. Let me go to page 5 of your statement and read to you:

"Even if Japan, the principal country affected by this bill, did not institute retaliatory restrictive trade actions,"—I don't think they have to institute anything. They have quite a few good things in place, quite frankly, but I will get to that question later—"the U.S. economy as a whole stands to suffer a net loss. Now in the current economic environment, however, such legislation might produce some positive results." Well, that is a nagging thing that we want to set off to the side. "These would be only temporary, however, not permanent; they would occur only because the economy is now experiencing considerable slack."

Incidentally, Ms. Rivlin, I want to say that you are one of the few who has made the point, and I think you are correct, that the changes we are seeing in the automobile industry now and were we to make productivity improving investments, that we are seeing structural unemployment changes. I think that is correct. I think that needs to be said. I think it also needs to be said and placed on this record that there has not been resistance by the United Auto Workers of America to that policy. That has been attested to would you agree, too?

Ms. **Rivlin**. I would agree with that.

Mr. **Bailey**. I think that is a very important statement to put on the public record. And also the same has been true of the steel industry, of the unions, of organized labor in the steel industry. I want to stress that point on the public record.

Now I will go on. "In a more fully employed economy the overall effects of H.R. 5133 would be decidedly negative: employment and output gains in the U.S. auto industry would be made possible only by shifts of resources from employment elsewhere in the economy."

Do you know what you are saying there? You are saying it is a bad investment. You are saying that, and I am using your assumption about no retaliation by Japan—you are telling us that investment in the U.S. automobile industry, going back to the paragraph on page 8 that Mr. Dannemeyer outlined, represents, apparently, an inefficient allocation of American resources. Now that is what you seem to be saying.

Forgive me, maybe I missed something. I am asking the question not to embarrass or catch you. But really, you know, the impact of what you have said there is that we are making a distortion which is not a wise capital investment, apparently, that all things being equal investment in the American automobile industry is not wise, because the market we are talking about is the American domestic market, Ms. Rivlin. We are not talking about marking these things in Antarctica and Australia, at least at this time in terms of who has been suffering at the hands of export and import policies of other countries. I would hope that we could and would some day.

Ms. **Rivlin**. I would have phrased it somewhat differently, but the point is the same: that if we had a fully employed economy, to distort investment—and sales—toward, the automobile industry—rather than let the market take its course—would be a mistake from the point of view of the American economy. In the end, it would give us a less efficient economy.

Mr. BAILEY. Well, then, why are we doing it now? You know, when you spoke—now wait a minute, because when I questioned you during the budget hearings I raised some questions about productivity with you. Those answers are on the record. I talked about the so-called Bailey bailout and investment tax credits and reinvestment in basic industries. And you made some very telling comments about the plight of capital intensive industries in the United States of America.

Now without getting into policy projections, which I think you did in terms of trade issues, and I think they leave some things out, should we not invest in our capital intensive industries in general? Should we not invest in the automobile industry?

Ms. RIVLIN. Certainly we should.

Mr. BAILEY. It is an important investment.

Ms. RIVLIN. Certainly we should, but we shouldn't protect it from foreign competition differently.

Mr. BAILEY. Then how do we deal with the Japanese problem? Because now we are in the real world; we are in that distortion that they continue at least, not that it originally wasn't well planned, or even fostered or supported by us. I mean they have a different tax structure and what not there. They do different things to encourage basic industries. I will finish up this way.

Why are all our capital intensive industries in trouble? I mean the constant discussion of this issue in terms of powerful labor unions and that kind of thing, I don't know what that responds to. I honestly don't. I don't think it is the right frame of reference. But that is my opinion. What I do see is a general problem in the United States of America with long-term capital-type industries. This is one. This is one that gets caught by consumer buyer preference. You said that yourself today. Now free trade, a free trade model worldwide is something I think would be beautiful among the free nations on Earth if we had the institutions to deal with them.

I think the goal is admirable. When you talk about what comparative advantage means, it is not there. I think you are using a thesis that has some holes in it. I don't think you are being consistent.

Ms. RIVLIN. I am not sure I understand the inconsistency.

Mr. BAILEY. I don't, either.

Ms. RIVLIN. I mean I am not sure what you——

Mr. BAILEY. I know what you mean. I am just saying I don't understand it, either. Should we invest in our capital intensive industries? Do they have a value? Is the vehicle industry important?

Ms. RIVLIN. I am not basically pessimistic about the future of the U.S. automobile industry. I don't think it is entirely going to go down the drain by any means. For the U.S. automobile industry to compete in world markets against industries as efficient as the Japanese automobile industry is going to take substantial capital investment. It is going to mean higher productivity—that is, less employment per car—in the U.S. automobile industry. It seems to me that is the way to go, not artificial protections.

Mr. **Bailey**. What do you suggest we do to accomplish that end? I happen to agree with you. The last tax bill, however, Ms. Rivlin, did away with safe harbor leasing and evil things. Bailey's bailout, reading the Reader's Digest's brilliant interview. What do we do to encourage investment in long-term capital? We have the problem of utilities. We are going to be energy short. We don't like nuclear energy. That is a bad mix. I can go on and on. I think you know the problems.

Ms. **Rivlin**. I think the general problems would be greatly aided by getting the economy growing again—getting the budget deficit down will bring interest rates down, and just creating a generally more favorable climate for investment. That is the most serious thing——

Mr. **Bailey**. I know it is, but it is not going to solve our basic problems—that economy can be riproaring. We saw this difficulty. President Kennedy was the last national leader we had with the sense to recognize it, quite frankly, and came up with something.

I want to compliment the chairman here, because I think it has to be put on the record as a tremendous tribute to him that in the Ways and Means tax bill there was an expensing provision that was offered that in my opinion was an absolute dream, turned down for political reasons. We all know that story. No reason in going over that. I would hope that when this bill is discussed we talk about some of the basic issues. I am perfectly willing to face up to the fact that it is a protectionist measure. I am willing to face up to the fact it is also a retaliatory measure. I am also willing to face up to the sad truth that we are in a different world, we have got to learn to deal with it differently and we have got to get tough or we are going to lose this free enterprise and efficient resource allocation model that you are promoting.

I want to promote it with you. But, geez, don't tell me that it is an inefficient situation to invest in this industry here when we are up against countries that do target and do aim at specific investments and specific industries and victimize us in the process, and say that somehow we are going to promote world free trade by letting well enough alone and not responding. Give me a better way to respond. I will be happy to equalize tax structure. I will be happy to change antitrust laws. I will be happy to do all those things if it is going to be the United States versus Japan. I would like nothing more than to prove my American pride by showing what we can do technologically and what our workers can do. But we shouldn't sit here and be a victim of practices that aren't fair.

Ms. **Rivlin**. So far as hard negotiating with other countries goes, including Japan, on freeing up their trade, I couldn't agree more.

Mr. **Bailey**. You do. That is a good step.

Ms. **Rivlin**. I don't think this bill would contribute to that.

Mr. **Bailey**. Then what would? Tell me what to do. I sat with my chairman in a meeting one time for half an hour, with all due respect to my political colleagues in Japan, I respect them, smart, persevering, and what tremendous respect for America. You know we have got a big heart and open arms, and we just believe in good faith. I sat there and listened for 20 minutes. It was ridiculous. What do we do? What do we do short term? What do we do?

You know we may lose nuclear leadership to the French in 10 or 15 years. We may lose the automobile edge, our steel industry. We could lose probably 40 to 50 percent, and in some specialty steels important to defense, completely lose it. In glass areas I can tell you right now we have reached a point where we may have to purchase those products abroad in producing armor-proof parts in armored vehicles. We are going to have to do something.

Ms. Rivlin. I think the main thing we need is a prosperous, growing economy. I am perfectly serious about that. I think as the economy grows, it will help for the basic industries that you are worried about. But it is not going to solve the problem. We are going to have to live with the fact—and the Japanese are living with it, too—that eventually, once older industries become less competitive, we have to emphasize the newer and growing ones.

Mr. Bailey. OK. Mr. Chairman, will you indulge me for one more minute? You have been so very kind.

Chairman Gibbons. Sure.

Mr. Bailey. That is the policy statement I am after and you innocently came out with that, I really think that is the problem. I just want to say this to you. I really think that is a problem in this administration, in the American financial community, and with many American businessmen and politicians who don't sit down and look at the importance of an industrial policy, and I don't believe in planning any more than you do, but we have got to do something. The choices are made in this society for short-term profits, so-called high growth technical industries. But we don't have the military and the diplomatic security to go along with that kind of interdependent and complex international economy that will fit your ideal model. And who is being hurt as we write tax policy and regulatory policy and conduct our trade negotiations, low-profit margin, long-term capital investment industries in the United States of America.

I would just suggest to you that as a matter of policy, that is going to place our country in some very perilous military and economic situations in the future. And I think the Japanese, perhaps correctly, perhaps not, in terms of how they accomplish this goal properly look at a steel industry as an important feedstock industry, for example, they properly look at the manufacturing sector as a very, very profitable export kind of market that gives them a response to what is a necessity worldwide, necessity for transportation.

I just hope that we develop some policies to respond to that. It has affected our steel industry for 20, 30 years. Maybe some industries just aren't going to ride the real quick profit, high return each quarter kind of environment. But maybe we do need them. Would you respond just briefly to that?

Ms. Rivlin. I don't have all the answers to what is a very serious set of problems. But I think the question this morning is, would this bill make the situation better or worse?

Mr. Bailey. Well, I think it is the only thing we can do.

Ms. Rivlin. It is just my judgment that protectionist measures in general, not just this bill, might give you a short-run gain for the automobile industry. But in the long run, they make the productivity of the economy in general worse rather than better.

Mr. Bailey. Thank you, Mr. Chairman.

Chairman Gibbons. Thank you.

Mr. Brodhead?

Mr. Brodhead. Thank you. Thank you, Mr. Chairman.

Dr. Rivlin, I guess you have gotten dragged into the middle of something that maybe you would have preferred not to have gotten dragged into. But let me ask you some questions about some of the assumptions that underlie the conclusions that you have drawn. On page 4 of your statement you say:

> It seems unlikely that Toyota and Nissan would shift sizable amounts of their production facilities to the United States because these firms would probably suffer the loss of their current cost advantages.

I wonder if it really is realistic to assume that these companies are going to walk away from a market in which they have been so hugely successful, especially in view of the fact that the Nissan itself is coming into the market, as you are I am sure aware, with a truck plant in Tennessee; that Honda has one facility up and going here and another one well on the way; that Renault is coming into producing in the American market in a major way; that Volkswagen is producing in the American market in a major way. These other companies have decided that they can locate here and want to locate here.

Why should we assume that Toyota and Nissan will not?

Ms. Rivlin. Well, it is certainly possible that they would. But it seemed likely to us that they would figure out that they probably wouldn't make a lot on making small cars here, because they would lose many of the cost advantages that they now have producing in Japan. They might continue to do what apparently has been part of the response to current voluntary agreements, namely: emphasize sales of a smaller number of higher profit luxury cars, and not try to manufacture a substantial number here.

Mr. Brodhead. Well, I——

Ms. Rivlin. Maybe my colleagues would want to comment on that.

Mr. Brodhead. Well, I think that that is important. It is an important point because that assumption that you are making has a great impact on the results that you predict in terms of the job——

Ms. Rivlin. Yes, it does.

[Pause.]

Mr. Brodhead. I will try to speak loud so everybody in the room can hear me.

That is obviously highly speculative. I mean some of the things you know, as you know from my serving on the Budget Committee and my dealings with you over the years I have a great deal of respect for your way of doing things. But I think you have to admit that it is pretty highly speculative to say they are not going to locate here in view of the fact that other people have located here. I mean we are not in the realm of economics here; we are in the realm of speculation. What evidence there is is evidence to the contrary. That is, other foreign producers have elected to do so.

Ms. Rivlin. No, on balance, the evidence seemed to point this way. But the conclusions are not especially sensitive to this assumption.

Mr. **Brodhead**. I think one of the important conclusions you draw is that you are suggesting there may not be a net gain of jobs in America. I guess for many of us, at least, that is the bottom line here, for many Members of Congress. They see this as a bill that would provide additional jobs in America. If you assume that the biggest producers are not going to locate here, then you have to assume that there are not going to be the jobs. So I regard it as being really a central point. I think that it is highly speculative indeed to assume that they are going to come to the conclusion that they can't compete here.

Frankly, from my discussions with many of the Japanese producers, I think that up until quite recently they have had an inferiority complex. I think that they have felt that they could not compete here. I think that they can compete here in the United States. It is hard to imagine these very capable business people walking away from the biggest market in the world, just turning their backs on it wouldn't seem to make much sense.

The other point that I wanted to get into is you talked about the fact that our market would not operate as efficiently if we had a vastly lower level of imports, imports coming into the country. I am sure you are aware of the fact that in Japan, the imports, imported cars are less than one percent of the market. Of course, nobody talks about the Japanese market as being inefficient. We always talk about the Japanese market in terms of being highly efficient. Yet that industry was built in Japan behind a protectionist wall. It was built, and there continues to be a whole series of measures, nontariff barriers, to other companies doing—auto companies and auto suppliers doing business in Japan. Yet, it is reputed to be a highly efficient operation and an efficient market.

I think I would point to that, the Japanese experience, as evidence that it is entirely possible to have a very efficient market while at the same time have the vast bulk of the production be domestic.

Ms. **Rivlin**. If we were starting a new automobile industry, then I think there would be a strong argument for erecting protection barriers against international competition as it got started, just as the Japanese did. But that is not the situation we are in. We have an automobile industry. If we reduce the competition it has to face, we will have higher prices for American cars. This is highly likely.

Mr. **Brodhead**. I don't know that we are reducing the competition. The competition seems to be expanding.

Ms. **Rivlin**. What is this bill for if not to reduce competition?

Mr. **Brodhead**. Even apart from this bill the competition seems to be expanding. In other words, production in this country, well, we now have three new producers within the last 5 years. We have three new domestic auto producers.

Ms. **Rivlin**. But we are probably going to end up with a more efficient automobile industry because we allowed the foreign competition in.

Mr. **Brodhead**. We not only allowed them in, we welcomed them to come to the United States and produce cars. We have three new domestic auto producers within the last 5 years. The other point that I think that you make that is an important one is that you are assuming that the Japanese are going to retaliate in some way. I wonder whether there is any evidence for that. I wonder whether there is any evidence that they have retaliated against other countries who have various forms of protection for their domestic auto industry, and it is a very long list as you are aware.

Why should we assume that? Especially given their very favorable balance of trade with the United States, it would seem to me that the last country in the world that would want to start a trade war with the United States would be Japan. In such a war they would have nothing to gain and everything to lose.

Ms. **Rivlin**. Well, not necessarily. In the first place—regarding why they would retaliate against us—it is a very big market. It is true that other countries do have restrictions that have hurt the Japanese auto industry. The ones that have domestic content restrictions of this nature tend to be small markets; Spain and Australia are the ones usually cited. They don't buy enough cars to be worth retaliating against. This is a very big market for the Japanese to lose.

Mr. **Brodhead**. Obviously; and the reason that it is a very big market, Dr. Rivlin, is that these other countries have found ways, whether local content laws or informal agreements or treaties or whatever, this whole long list of countries has found ways to restrict the Japanese penetration of their automobile markets. We in this country do not. That is one of the major reasons why we recognize and understand their economic problems. They have to export in order to survive. We want them to survive. We want them to be strong. We want them to grow. But given the fact that other countries are putting up a wall against their imports, they have made a sensible decision, and that is the place to go is the United States.

So I think an artificial situation has been created. It is not a free market. We are the only open market in the world, are we not? Is there another major country in the world where there is an open market for automobiles?

Ms. **Rivlin**. There are varying degrees of restriction. But I think the point really is that it is hard to defend the restrictions anywhere. For the United States to put up barriers of this sort is just to make the whole world situation substantially worse. We are not defending restrictions in other countries.

Mr. **Brodhead**. Well, we are not defending them, yet we have to live in the world in which they exist. If other countries are going to do this and the United States is not, then what is going to happen is pretty clear. Exactly what has been happening. The Japanese producers will go where they can go, and these are not market forces necessarily that are dictating where they can go. They have been shut out of all the other major markets in the world, or at least limited.

Ms. **Rivlin**. Well, that is a different situation.

Mr. **Brodhead**. Well, they are limited——

Ms. **Rivlin**. Japanese sell a lot of cars in a lot of markets.

Mr. **Brodhead** [continuing]. In the United Kingdom, Belgium, all of Europe virtually, they are excluded. Where are they going to go to sell their cars except to the United States. They are playing chess and we are playing "Monopoly." They are talking about free markets. Well, there isn't a free market except for this one. We are saying the free market works. Well, it depends on what is your definition of works. I don't know if you call a 10-percent rate of unemployment as working. That is not working.

Ms. RIVLIN. I don't think the 10-percent rate of unemployment can be laid entirely at the door of international trade restrictions. Clearly not.

Mr. BRODHEAD. Clearly the automobile industry unemployment and parts and suppliers and so on is a very sizable part, perhaps 10 percent of all the unemployment in the country.

Ms. RIVLIN. That is right. But it is caused in part by the general recession; in very large part by the general recession, and in part by the shift in automobile demand. But the point is that every country can reason this way. They do it, so why don't we do it? And to go further down this line just makes, restricts trade all around the world, and makes us all live less well.

Mr. BRODHEAD. Well, I guess as a general proposition I can't a whole lot disagree with what you are saying. Unfortunately I represent a district in which people aren't living very well right now under the current situation.

Ms. RIVLIN. That is right.

Mr. BRODHEAD. We have an extraordinary rate of unemployment that has persisted for about 3 years, and it is hard to imagine for us that we could be worse off under this legislation.

Ms. RIVLIN. I don't think you would be in Michigan. I think clearly the passage of this legislation would benefit, and we say so strongly in the statement, would benefit the automobile and automobile-related industries. The question is, at what cost?

Mr. BRODHEAD. Thank you very much, Doctor.

Thank you, Mr. Chairman. We have a vote, do we, Mr. Chairman?

Chairman GIBBONS. Yes; I think I just missed it.

Mr. BRODHEAD. Well, I am going to try to catch it, if I might, Mr. Chairman.

Chairman GIBBONS. I will walk over there with you then. We will recess.

[Recess.]

Chairman GIBBONS. Let me make an administrative announcement.

Do you want to take one more witness now and then come back after lunch? I have a luncheon engagement I can't break. What do you want to do?

Mr. BAILEY. Will our witness list last the 10-day referral?

Chairman GIBBONS. We have a lot more than that. We have a lot more than that.

Mr. BAILEY. I was just kidding. I guess I was saying whatever you think, Mr. Chairman, is fine.

Mr. PEASE. I am at your disposal.

Chairman GIBBONS. Why not break now and come back at 1:30.

Mr. PEASE. No votes from the audience here. [Laughter.]

Chairman GIBBONS. We want to try to accommodate people. We have a vote on, and then, bingo, here we go. All right, we will come back at 1:30.

[Whereupon, at 11:35 a.m., the subcommittee was recessed, to reconvene at 1:30.]

AFTERNOON SESSION

Chairman GIBBONS. We will have our meeting come back to order.

Our first witness is Mr. John Hemphill of J. D. Power & Associates.

Mr. Hemphill.

STATEMENT OF JOHN M. HEMPHILL, JR., EXECUTIVE VICE PRESIDENT, J. D. POWER & ASSOCIATES

Mr. HEMPHILL. Good afternoon, Mr. Chairman.

Chairman GIBBONS. Mr. Hemphill, we welcome you. We appreciate your coming. We are sorry we are running a little bit late.

But just take your time and you may proceed as you wish. We look forward to hearing you.

Mr. HEMPHILL. I have a copy of the full talk. I am going to summarize it for the purposes of this committee this afternoon.

Chairman GIBBONS. All right, sir, well, it looks like a very interesting one here. Go right ahead.

Mr. HEMPHILL. As you say, my name is John M. Hemphill, Jr. I am the executive vice president of J. D. Power & Associates.

Trained as an economist, my expertise is in the area of measuring and analyzing consumer behavior. The company in which I am an officer specializes, more than any other organization in the country, in independent automotive consumer research.

As it has been for the 15 years of life of our company, the mission is to determine what U.S. consumers are thinking and doing about their personal transportation needs.

The major thrust of our business is conducting automotive consumer surveys that we fund and design, ourselves, and then market to interested individuals or organizations.

As might be expected, the automobile manufacturers, domestic, Japanese, and European, are regular subscribers to our studies, and the Federal Government agencies, the Departments of Transportation, Energy, and Commerce, are also users of our multiclient research.

Chairman GIBBONS. That is interesting. I did not realize we had entrepreneurs like that in this country.

Go ahead.

Mr. HEMPHILL. We do conduct custom or proprietary research for domestic and foreign manufacturers, and the Government, we feel that our independent status is more important for maintaining our objectivity, and thus, our service to the industry.

We are not representing any manufacturer, foreign or domestic, in our testimony. We are presenting the consumers' viewpoint and concerns as they express them to us in our survey research.

Our thrice-yearly national survey will be our principal reference here today. We have done this since mid-1979 and it contains a sample representative of the U.S. driving-age population.

In addition to this, another survey——

Chairman GIBBONS. You have 5,000 people in your sample?

Mr. HEMPHILL. Yes, sir.

Chairman GIBBONS. Wow, you do a lot more than some of the other pollsters, don't you? They usually do about a fourth that many.

Mr. HEMPHILL. That is correct. We survey 5,000 individuals each time three times a year, a different 5,000. We cover such things as vehicle ownership, usage, attitudes, and opinions.

The other survey we conduct on an annual basis provides unique information about how a sample of 7,500 customers of some 22 domestic and foreign vehicle nameplates evaluate their purchase.

This study furnishes a necessary perspective for this committee to evaluate the opinions consumers have about legal solutions to market and industry problems.

So, to begin, just how satisfied are American car buyers with the products they have purchased? How do they rate the manufacturer and dealer from which they bought their cars?

Given their ownership experience, how likely are they to buy from the same car maker again?

In April and May of this year, we surveyed 7,500 consumers, representing 22 nameplates, that had purchased their car 12 to 14 months prior to receiving our questionnaire.

The reason we conduct this survey is to furnish our clients with objective and comparative measures of how their own customers assess the car they purchased.

Several clients have used the results of the study to institute action programs on their own designed to improve relatively weak standings in either product quality or dealer servicing.

After-sales automobile servicing and maintenance has always been the Achilles heel for car makers. As advanced technology makes the repair of the average new car more difficult and complex, the manufacturers' exposure to dissatisfied customers becomes even greater. At the same time, car buyers continue to develop a growing concern for product quality and dependability. In fact, dependability/trouble-free operation is now the single most important car attribute in the minds of automotive consumers, even leading such factors as fuel economy, purchase price, safety, and performance by a wide margin.

Over time, customer loyalty is based on the in-use experience owners have with the cars they purchased. As the U.S. automobile market increasingly becomes a replacement market, loyalty becomes more important as manufacturers fiercely compete for the return customer.

It is the satisfaction, or lack of it, with dealer service that builds or destroys the consumer's desire to repurchase from the same dealer and/or the same manufacturer. This is where the battle will be won or lost.

There will be no long run for an automaker that cannot achieve extremely high repurchase rates. Manufacturers must place more and more emphasis on intrinsic product quality and the quality of after-sale service.

This is imperative not only because customer loyalty is necessary to thrive in a replacement market, but also because the automobiles from which consumers are choosing are increasing similar in appearance, features, fuel economy, and technology.

In our customer satisfaction index, we examine the many factors that contribute to the owner's satisfaction with the automobile during the first year of ownership. Our research points out several areas which tend to have the greatest impact on owner satisfaction during and directly following the honeymoon period, the first year of ownership. The basic problems of domestic manufacturers are evident from the results of this survey. The overall ranking shows that not one domestic automaker exceeds the industry average.

All the manufacturers ranking above average are foreign, with six Japanese and four European making up the top 10, and these findings generally coincide with our findings of 1 year ago.

An examination of a few aspects of owner satisfaction will give an idea of the competitive weaknesses among the low-rating nameplates. For example, problems on delivery of the vehicle to the customers is the first indication an owner has of whether he/she made the right purchase decision.

As new car prices have risen, so have consumer expectations that the car they receive should be unblemished.

Consistent with our findings last year, domestic make owners report a significantly higher incidence of problems on delivery than owners of imports, 52 percent versus 42 percent.

Chairman GIBBONS. I am sorry, what was that again?

Mr. HEMPHILL. These are problems on delivery.

Chairman GIBBONS. Do you mean like tar being in the trunk like I had on my new GM car, the bolt being out of the door, the main bolt that holds the door on my new GM car, little things like that?

Mr. HEMPHILL. All of the fit and finish.

Chairman GIBBONS. Yes. It is hard to miss a bolt that is that big around, the head of it, right in the left driver door, but they did on my new Oldsmobile.

Mr. HEMPHILL. Those are the kinds of problems——

Chairman GIBBONS. And it will not come off.

Mr. HEMPHILL. These would be——

Chairman GIBBONS. That is what you call "good workmanship."

Mr. HEMPHILL. These would be the blemishes the owners observe when they take the car from the dealership. There is a 10 percentage point spread between the domestic and the imports on this measure.

Now, owners of Toyota and Honda, two of the higher ranking, the second- and third-ranked leaders, report the lowest incidence of problems on delivery overall, 23 percent and 24 percent respectively, while Lincoln-Mercury (46 percent) and Ford (48 percent) are the only domestic automakers with an incidence of delivery problems under 50 percent.

Ford, it might be added, improved significantly in this category over last year's findings and in comparison to other domestic makes.

The reputation the Japanese have built for quality can be traced in large part to delivering cars that are problem free. While less than half of the domestically produced cars are problem free on delivery, two-thirds of the Japanese-built imports are trouble free when buyers receive them.

The payoff in a nameplate experiencing low delivery problems——

Chairman GIBBONS. Probably it is the long sea voyage that helps.

Mr. HEMPHILL. The payoff for the automakers that deliver cars with low delivery problems can be seen in owners' repurchase intentions: The Toyota and Honda owners who reported the lowest incidence of problems on delivery, also reported the second and third highest repurchase intentions.

One of the most important elements of overall satisfaction is whether or not the customer must return to the dealer for a problem that was not fixed to their satisfaction in the first place.

Again, Honda and Toyota owners report the lowest incidence of returning to the dealer for unsatisfactory service. Owners of domestic makes must return far more frequently to their dealers for unsatisfactory service and fully 4 out of 10 returned to the dealership two or more times because service was not performed to the owner's satisfaction.

Other elements of the overall satisfaction of the customer which are measured by the CSI include delays in service due to unavailability of parts, overall standards of repair service, service department recommendations, repurchase intentions of the same make and at the same dealer, and evaluations of specific service attributes.

It must be noted that all of these aspects of after-sales support to the consumer interact in shaping overall satisfaction. Further, our research indicates that Japanese imports work toward satisfying their customers through product quality, whereas European manufacturers succeed in satisfying their customers through above average performance of after-sales service.

In summarizing to this point, I should like to make two points about customer satisfaction and the data reviewed here. First, it is not just the Japanese that are doing a much better job of supplying products that furnish higher levels of customer satisfaction; the European makers are, too.

The Japanese achieve this more through emphasis on intrinsic product quality, while the European nameplates on quality of after-sale service, but the result is the same—an owner group with higher intentions to repurchase the same nameplate and more likely to recommend their purchase to others.

Second, the industry leaders are not resting on their laurels; each has specific programs directed at improving their already above-average positions.

Some have made notable improvements in just 1 year. Thus, the domestic manufacturers have a moving target to aim for while they struggle to maintain position and achieve incremental gains.

It is not so much that the competitive game is lost to the imports; it is a situation where the domestic automaker must decide on where their competitive advantage lies. For the issue is that with customer satisfaction levels the way they are among competing nameplates and how potent this factor is for gaining customer loyalty, there is very little that could be gained from even more market intervention by the Federal Government.

Import quotas, tariffs, or local content requirements will do nothing to enhance what the consumer cares most about in purchasing and owning a new car.

Will the proposed legislation lead to a reduction in problems on delivery, the number of mechanical problems, or repeat visits to the dealer?

How will the protection of the domestic industry enhance the dependability of the next car I buy? How will requirements for domestic labor and parts assure me of having a trouble-free automobile?

These are principal concerns of consumers. Just as significant for understanding the consumer perspective is the effect of proposed legislation on future car prices and how important this is to them.

It is also informative to know how consumers assess the efficacy of legislation designed to help the domestic industry. These are subjects to which we now turn.

American consumers have specific views about the causes of the current plight of the domestic auto industry. They do not blame the Japanese or Europeans.

On a list of possible alternatives from which to choose, three out of four either strongly agree or agree with the statement: "Domestic car manufacturers have not responded to consumer needs as well as the Japanese import manufacturers."

The percentage agreeing was highest in California (84 percent), and lowest in the West-South Central (70 percent). Two-thirds agreed that Japanese cars possess more of the features consumers are looking for.

In rating the management of the automakers, only 1 in 10 believe U.S. management to be superior to that of Japanese companies.

A more definitive consumer evaluation of the U.S. auto industry management is indicated by our survey item dealing with the ability of U.S. engineers to surpass the Japanese in designing automobiles.

More than three-fourths of American consumers say that if U.S. auto industry management gave proper direction, their workers could design cars with better quality and fuel efficiency than the Japanese.

American consumers are ambivalent as to whether U.S. car assembly line workers are the principal reason for lower quality of American-built cars—37 percent say they are, 27 percent say no, and 30 percent are uncertain.

They are more definitive about what U.S. auto workers should do to improve the competitiveness of their industry. Nearly three-fourths of the driving-age population is aware that the United Auto Workers receive higher hourly wages than Japanese auto workers.

They estimate their average hourly wage very accurately at a little over $20 per hour. And while they do not resent UAW wages—only 17 percent say workers are overpaid—nearly two-thirds of the driving public believe the auto workers should receive lower pay so that U.S. manufacturers can compete on a more equal footing with the Japanese automakers.

This reflects that over two-thirds say that using U.S. workers will cause American-built Japanese cars to be as expensive as cars by domestic manufacturers.

These findings underscore some fundamental dynamics about the U.S. auto industry and market. The energy crisis in the 1970's and the availability of well-built, fuel-efficient cars from Japan, brought competition to a market that had been dominated by a highly concentrated industry whose structure, conduct, and performance had hardly been tested.

When the domestic industry could not or did not respond to the change of events, and when consumers found alternative products right for the time, and gained the added bonus of dependable transportation, consumers finally had standards against which to judge what was being made available to them in the marketplace.

Truly, a market that had been supplier controlled for so long, experience a revolution where the consumer gained the upper hand.

If this is not the case, then why have imports, now on restrictions for volume, been setting monthly sales penetration records during the unprecedented string of 3 years of dismal domestic automobile sales?

From the consumers' viewpoint, the challenge to this committee is to preserve the competitiveness of the single most important product market in this country.

Any form of protection would attempt to turn back the clock and help insulate an industry for the benefit of the few.

One reason the proposed legislation before this committee has gotten this far is because domestic automakers are feeling the double whammy of a weak competitive position and a weak economy.

Consumers are concerned about unemployment in the industry, but they are more concerned about the quality of the cars they own and the price they must pay to satisfy their needs. Currently, the price of a new vehicle is the single greatest deterrent to buying, and this leads such other factors as interest rates, family budget constraints, fuel costs, and business conditions by a wide margin.

Any protection measure that would increase the price of new vehicles further would constrain future sales.

Their concern about unemployment can be seen in how consumers view Government intervention to protect the domestic industry, but they are uncertain about the efficacy of such actions.

Regardless of which specific proposal is presented to them for reaction, whether it be an import tax, quotas, or requirements for having local assembly or content, when respondents are forced to choose among alternative intervention methods, they are about evenly split about the desirability of such intervention, with a sizable group—about one in four—being consistently neutral or uncertain.

The results are clear, though, when they are given a choice as to whether the Federal Government should or should not intervene to help the domestic auto industry. They do not favor any such action.

They opposed the subsidy to Chrysler, and they were against the "voluntary" restrictions now in force.

Consumers were right when they anticipated higher car prices and constrained choices. And they were correct in assuming they would have to pay for market intervention by the Government.

What consumers are not aware of, by and large, are the additional unintended benefits the Japanese gained by restricting the number of cars they can offer in the United States.

The United States is being finessed by the Japanese. First, as is well known, the Japanese rationally decided to import more expensive, option-loaded models, and hastened their product plans to fill out their product line at the top, and delayed the introduction of new low-priced minicars, all of which are available in many other countries.

Second, the "holding pattern" brought on by current restrictions allowed them to shift priorities and resources to more firmly entrench their nameplates in other parts of the world where our domestic nameplates were strongest.

We have protected, aided, and abetted the Japanese auto industry with our Federal actions. Never mind that they produce higher-quality cars at a lower cost. During the past 2 years, they could well have overproduced for the U.S. market, committed more production for the United States, and oversupplied their dealers with products that would not sell under the adverse economic conditions we have experienced.

The much heralded, just-in-time inventory scheduling, so necessary for keeping production costs down, may have been interrupted often enough by the uncertainties of our marketplace to alter their costs, prices, and quality.

But, no, we insulated them from our economic woes, actually sponsored even greater penetration and market share, created conditions to fulfill their product line strategy, guided them to exploit markets they coveted elsewhere, and made future planning much easier for them.

I will summarize. There is a revolution occuring in the U.S. automobile market and worldwide auto industry.

Stimulated by high fuel prices and vehicle operating costs, and the advent of a competitive market induced by foreign competition, the American consumer has broken irretrievably from tradition.

The palaver from auto advertising does nothing more than heighten nameplate awareness. Even though themes have shifted from elegance and style to product and technology, the automotive consumer is bored with these appeals so similar and repetitive.

For their next purchase, they are shopping around more, and relying on their own experiences with their vehicles, along with the advice of others.

What has happened to automotive consumer loyalty demonstrates the upheaval in the U.S. marketplace. Overall, only 23 percent of domestic carowners indicate they would stick with their chosen company.

GM's X-, J-, and A-body cars are examples of how a lack of differentiation has served to eradicate interdivisional loyalty.

Compared with the 1950's and 1960's, GM has simply lost its repeat clientele. Our Customer Satisfaction Index shows that only 36 percent of 1981 Cadillac owners say they would definitely buy another Cadillac; 27 percent of Oldsmobile owners say they would buy another Olds. For Buick, it is 22 percent.

Other domestic automakers fare even worse, 23 percent of AMC owners say they would stick with the company's product lineup. It is 22 percent for Ford and 21 percent for Chrysler.

For imports, 32 percent of their owners are loyalists. The best of the imports is Mercedes-Benz, with 59 percent of the sample saying they would definitely buy another Mercedes; 46 percent would definitely stay with Honda, 45 percent for BMW, 42 percent for Volvo and 40 percent for Toyota.

That fact that potential automobile buyers have fundamentally altered their predispositions and behavior is already affecting the products being offered to them and the way they are sold.

The retail end of the car business must change, too, since car dealers must contend with this new consumer.

In this context, the futility of market intervention by the Federal Government is readily apparent for it impedes inevitable forces at work, and would, whether the remedy is local content requirements or continuance of import restrictions, damage the economy and consumers negatively and needlessly.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF JOHN M. HEMPHILL, JR., PH. D., EXECUTIVE VICE PRESIDENT, J. D. POWER & ASSOCIATES

HOW CONSUMERS VIEW FURTHER PROTECTION FOR THE U.S. AUTOMOTIVE INDUSTRY

Mr. Chairman and members of the subcommittee, my name is John M. Hemphill, Jr. I am the Executive Vice President of J. D. Power & Associates. Trained as an economist, my expertise is in the area of measuring and analyzing consumer behavior. The company in which I am an officer specializes, more than any other organization in the country, in independent automotive consumer research. As it has been for the past 15 years, the mission of our firm is to determine what U.S. consumers are thinking and doing about their personal transportation needs. The major thrust of our business is conducting automotive consumer surveys that we fund and design, and then market to interested individuals or organizations. As might be expected, the automobile manufacturers, domestic, Japanese, and European, are regular subscribers to our studies, and the federal government agencies, including the U.S. Departments of Transportation, Energy, and Commerce are also users of our multiclient research. Although we conduct custom or proprietary research for domestic and foreign manufacturers, and the government, we feel that our independent status is more important for maintaining our objectivity, and thus, our service to the industry.

We are not representing any manufacturer, foreign or domestic, in our testimony. We are presenting the consumers' viewpoint and concerns as they express them to us in our survey research.

As a full service market research company, we use a variety of research approaches to analyze what is the most complex and dynamic product market in this country. Our independent studies range from vehicle owner studies to consumer satisfaction with dealer service, and new product research for estimating market potential to our on-going thrice yearly national survey and monitoring of the driving population.

This national survey will be my principal reference for my testimony regarding H.R. 5133. We call this survey the Automotive Consumer Profile (ACP). Since mid-1979, we have been surveying a representative sample of the U.S. driving age population. The same size for each of these tri-annual ACP reports is about 5,000 individuals aged 16 and older, comprising about 3,000 households. ACP is the only survey of its kind devoted to tracking vehicle ownership patterns, vehicle usage, buying intentions and preferences; and attitudes, opinions and expectation of consumers about current events related to the automotive market or industry. On several occasions during the past three years, and most recently during the Spring of this year, this survey asked consumers to give their reactions to legislated remedies to enhance the market position of the domestic auto industry.

In addition to our Automotive Consumer Profile, which will supply the Subcommittee with evidence on consumer attitudes about regulatory measures, another survey we conduct annually, called our Customer Satisfaction Index, provides unique information about how a sample of 7,500 customers of some 22 domestic and foreign vehicle nameplates evaluate their purchase. This study furnishes a necessary perspective for this committee to evaluate the issue-specific opinions consumers have about legal solutions to market and industry problems.

CUSTOMER SATISFACTION

Just how satisfied are American car buyers with the products they have purchased? How do they rate the manufacturer and dealer from which they bought their car? Given their ownership experience, how likely are they to buy from the same car maker again?

In April and May of this year we surveyed 7,500 consumers, representing 22 nameplates, that had purchased their car 12–14 months prior to receiving our questionnaire. Random selection of potential respondents within each nameplate surveyed provided a sample of models and body styles representative of each manufacturer's sales mix.

The reason we conduct this survey is to furnish our clients with objective and comparative measures of how their own customers assess the car they purchased. Several clients have used the results of the study to institute action programs designed to improve relatively weak standings in either product quality or dealer servicing.

After-sales automobile servicing and maintenance has always been the Achilles Heel for car makers. As advanced technology makes the repair of the average new car more difficult and complex, the manufacturers' exposure to dissatisfied customers becomes even greater. At the same time, car buyers continue to develop a growing concern for product quality and dependability. In fact, dependability/trouble-free operation is now the single most important car attribute in the minds of automotive consumers, even leading such factors as fuel economy, purchase price, safety, and performance by a wide margin. Over time, customer loyalty is based on the in-use experience owners have with the cars they purchased. As the U.S. automobile market increasingly becomes a replacement market, loyalty becomes more important as manufacturers fiercely compete for the return customer. It is the satisfaction, or lack of it, with dealer service that builds or destroys the consumers' desire to repurchase from the same dealer and/or the same manufacturer. This is where the battle will be won or lost.

There will be no "long run" for an automaker that cannot achieve extremely high repurchase rates. Manufacturers must place more and more emphasis on intrinsic product quality and the quality of after-sale service. This is imperative not only because customer loyalty is necessary to thrive in a replacement market, but also because the automobiles from which consumers are choosing are increasingly similar in appearance, features, fuel economy, and technology. To be sure, products can be differentiated in advertising and in showroom sales presentations, but consumers are relying more and more on their own experience and on the reputation of the manufacturer in their decision to purchase. What the pre-sold shopper is looking for more than anything else is dependability, making dealer service and products with built-in quality the crucial differentiating factors. Clever media promotion, price discounts, or showroom appeals cannot overcome a reputation for products that do not furnish trouble-free operation, or automobiles with problems that cannot be repaired quickly on the first visit back to the dealer.

In our annual Customer Satisfaction Index (CSI) study we examine the many factors that contribute to an owner's satisfaction with the automobile during the first year of ownership. Our research points out several areas which tend to have the greatest impact on owners' satisfaction during and directly following the "honeymoon" period, or the first year of ownership. These factors are assigned point totals which when added together and multiplied by a constant factor, provide the industry average level of satisfaction (CSI = 100 points) and from there provides a numerical index rating for each nameplate. Thus, manufacturers are provided with an objective rating of their after-sales customer satisfaction in contrast to competitive nameplates and the industry as a whole.

The basic problems of the domestic manufacturers are evident from the results of this survey. The overall ranking shows that not one domestic automaker exceeds the industry average. All the manufacturers ranking above average are foreign, with six Japanese and four European making up the top ten, and these findings generally coincide with our findings a year ago.

1982 CUSTOMER SATISFACTION INDEX

[Industry = 100]

	1982	1981
Mercedes-Benz	155	135
Toyota	149	140

1982 CUSTOMER SATISFACTION INDEX—Continued

[Industry = 100]

	1982	1981
Honda	148	127
BMW	126	(1)
Subaru	117	115
Volvo	115	105
Isuzu	112	(1)
Mazda	107	121
Datsun	106	106
Volkswagen	102	88
Porche/Audi	97	(1)
Other imports (Fiat, Saab, Jag, etc.)	97	83
Mitsubishi	95	(1)
Oldsmobile	92	(1)
Lincoln/Mercury	92	(1)
Cadillac	92	(1)
Chrysler	91	101
Ford	89	80
Chevrolet	89	89
Buick	87	(1)
AMC	81	74
Pontiac	72	(1)
Renault	59	75

(1) Not available.

Source: Customer Satisfaction Index, June 1982.

An examination of a few aspects of owner satisfaction will give an idea of the competitive weaknesses among the low rating nameplates. For example, problems on delivery of the vehicle to the customers is the first indication an owner has of whether he/she made the right purchase decision. As new car prices have risen, so have consumer expectations that the car they receive should be unblemished.

Consistent with our findings last year, domestic make owners report a significantly higher incidence of problems on delivery than owners of imports, 52% vs. 42%. Owners of Toyota and Honda, the number 2 and 3 ranked CSI leaders, report the lowest incidence of problems on delivery overall, 23% and 24% respectively, while Lincoln-Mercury (46%) and Ford (48%) are the only domestic automakers with an incidence of delivery problems under 50%. Ford, it might be added, improved significantly in this category over last year's findings and in comparison to other domestic makes.

The reputation the Japanese have built for quality can be traced in large part to delivering cars that are problem-free. While less than half (48%) of the domestically produced cars are problem-free on delivery, two-thirds of the Japanese-built imports are trouble-free when buyers receive them.

The pay-off in a nameplate experiencing low delivery problems can be seen in owners' repurchase intentions: The Toyota and Honda owners who reported the lowest incidence of problems on delivery, also reported the second and third highest repurchase intentions.

One of the most important elements of overall satisfaction is whether or not the customer must return to the dealer for a problem that wasn't fixed to their satisfaction in the first place. The frustration of an owner who returns time and time again to repair the same problem cannot be explained in any less terms than "loss of sales". The owner returning to the same dealer for unsatisfactory service, while not likely to purchase again from the same dealer, is also not likely to repurchase the same make of car.

Again, Honda and Toyota owners report the lowest incidence of returning to the dealer for unsatisfactory service (25% and 28% respectively). Owners of domestic makes must return far more frequently to their dealers for unsatisfactory service as sixteen percent returned once, and fully four out of ten (41%) returned to the dealership two or more times because service was not performed to the owners' satisfaction.

Other elements of the overall satisfaction of the customer which are measured by the CSI include delays in service due to unavailability of parts, overall standards of repair service versus competitive nameplates, service department recommendations, repurchase intentions of the same make and at the same dealer, and evaluations of specific service attributes.

It must be noted that all of these aspects of after-sales support and servicing interact in shaping overall satisfaction. Further, our research indicates that Japanese imports work towards satisfying their customers through product quality, whereas European manufacturers succeed in satisfying their customers through above average performance of after-sales service.

However it is achieved, there can be no doubt that the key to maintaining a strong sales base is through satisfied customers. Manufacturers who do not realize this and fail to improve dismal performances in these important areas shaping customer satisfaction, run the risk of no longer having customers to satisfy.

In summarizing to this point, I should like to make two points about customer satisfaction and the data reviewed here. First, it is not just the Japanese manufacturers that are doing a much better job of supplying products that furnish higher levels of customer satisfaction; the European makers are too. The Japanese achieve this more through emphasis on intrinsic product quality, while the European nameplates on quality of after-sale service, but the result is the same—an owner group with higher intentions to repurchase the same nameplate and more likely to recommend their purchase to others.

Second, the industry leaders are not resting on their laurals; each has specific programs directed at improving their already above average positions. Some have made notable improvements in just one year. Thus, the domestic manufacturers have a moving target to aim for while they struggle to maintain position and achieve incremental gains.

It is not so much that the competitive game is lost to the imports; it is a situation where the domestic automakers must decide on where their competitive advantage lies or in what market their disadvantage is least. For the issue is that with customer satisfaction levels the way they are among competing nameplates and how potent this factor is for gaining customer loyalty and high repurchase rates, there is very little that could be gained from even more market intervention by the federal government. Import quotas, tariffs, or local content requirements will do nothing to enhance what the consumer cares most about in purchasing and owing a new car. Will the proposed legislation lead to a reduction in problems on delivery of any new car, the number of mechanical problems, or repeat visits to the dearler? How will the protection of the domestic industry enhance the dependability/reliability of the next car I buy? How will requirements for domestic labor and parts assure me of having a trouble-free automobile? These are principal concerns of consumers. Just as significant for understanding the consumer perspective is the effect of proposed legislation on future car prices and how important this is to them. It is also informative to know how consumers assess the efficacy of legislation designed to help the domestic industry. These are subjects to which we now turn.

HOW CONSUMERS VIEW PROTECTION FOR THE DOMESTIC INDUSTRY

American consumers have specific views about the causes of the current plight of the domestic auto industry. They do not blame the Japanese or Europeans. On a list of possible alternatives from which to choose, three out of four either strongly agree or agree with the statement: "Domestic car manufacturers have not responded to consumer needs as well as the Japanese import manufacturers". The percentage agreeing was highest in California (84%), and lowest in the West-South Central (70%). Two-thirds agreed that Japanese cars possess more of the features consumers are looking for.

In rating the management of the automakers, only one in ten believe U.S. management to be superior to that of Japanese companies. A more definitive consumer evaluation of the U.S. auto industry management is indicated by our survey item dealing with the ability of U.S. engineers to surpass the Japanese in designing automobiles. More than three-fourths say that if U.S. auto industry management gave proper direction, their workers could design cars with better quality and fuel efficiency than the Japanese.

American consumers are ambivalent as to whether U.S. car assembly line workers are the principal reason for lower quality of American built cars—37% say they are, 27% say no, and 30% are uncertain.

Consumers are more definitive about what U.S. auto workers should do to improve the competitiveness of their industry. Nearly three-fourths of the driving age population is aware that the United Auto Workers receive higher hourly wages than Japanese auto workers. They estimate their average hourly wage very accurately at a little over $20 per hour. And while they do not resent UAW wages (only

17% say workers are overpaid), nearly two-thirds of the driving public believe the auto workers should receive lower pay so that U.S. manufacturers can compete on a more equal footing with the Japanese automakers. This reflects consumers' concern about vehicle prices. It should also be noted that over two-thirds (69%) say that using U.S. workers will cause American-built Japanese cars to be as expensive as cars by domestic manufacturers.

Consumers have higher expectations and standards, not only due to competition, but also because they perceive they are paying more for less—less room and power. The sportiness of the imports gives them an added competitive boost on top of fuel efficiency and dependability, while the domestics are perceived as building small cars with big car characteristics.

These findings underscore some fundamental dynamics about the U.S. auto industry and market. The energy crisis in the 70's and the availability of well-built, fuel efficient cars from Japan, brought competition to a market that had been dominated by a highly concentrated industry whose structure, conduct, and performance had hardly been tested. When the domestic industry could not or did not respond to the change of events, and when consumers found alternative products right for the time, and gained the added bonus of dependable transportation, consumers finally had standards against which to judge what was being made available to them in the marketplace.

Truly, a market that had been supplier-controlled for a long, experienced a revolution where the consumer gained the upper hand. If this is not the case, then why have imports, now on restrictions for volume, been setting monthly sales penetration records during the unprecedented string of three years of dismal domestic automobile sales?

From the consumers' viewpoint, the challenge to this committee is to preserve the competitiveness of the single most important product market in this country. Any form of protection would attempt to turn back the clock and help insulate an industry for the benefit of the few. One reason the proposed legislation before this committee has gotten this far is because domestic automakers are feeling the double-whammy of a weak competitive position and a weak economy. Solutions cannot be legislated to address these problems.

Consumers are concerned about unemployment in the industry, but they are more concerned about the quality of the cars they own and the price they must pay to satisfy their personal transportation needs. Currently, the price of a new vehicle is the single greatest deterrent to buying, and this leads such other factors as interest rates, family budget constraints, fuel costs, and overall business conditions by a wide margin. Any protection measure that would increase the price of new vehicles further would constrain future sales.

Their concern about unemployment can be seen in how consumers view government intervention to protect the domestic industry, but they are uncertain about the efficacy of such actions. Regardless of which specific proposal is presented to them for reaction, whether it be an import tax, quotas, or requirements for having local assembly or content, when respondents are forced to choose among alternative market intervention methods, they are about evenly split about the desirability of such intervention, with a sizeable group (about one in four) being neutral or uncertain.

The results are clear, though, when they are given a choice as to whether the federal government should or should not intervene to help the domestic auto industry. The driving age population does not favor any such action. They opposed the subsidy to Chrysler, and they were against the "voluntary" restrictions now in force. Consumers were right when they anticipated higher car prices and constrained choices resulting from current import volume restrictions. And they were correct in assuming they would have to pay for market intervention by the government.

What consumers are not aware of, by and large, are the additional unintended benefits the Japanese gained by restricting the number of cars they can offer in the U.S. The U.S. is being finessed by the Japanese. First, as is well known, the Japanese rationally decided to import more expensive, option-loaded models, and hastened their product plans to fill out their product line at the top, and delayed the introduction of new low-priced mini-cars, already available in other countries. Second, the "holding pattern" brought on by current restrictions, allowed them to shift priorities and resources to more firmly entrench their nameplates in other parts of the world where our domestic nameplates were strongest. We have protected, aided, and abetted the Japanese auto industry with our federal actions. Never mind that they produce higher quality cars at a lower cost. During the past two years they could well have over-produced for the U.S. market, committed more production for the U.S., and over-supplied their dealers with products that would not sell under the adverse economic conditions we have experienced. The much heralded, just-in-time inventory scheduling, so necessary for keeping production costs down, may have been interrupted often enough by the uncertainties of our marketplace to alter their costs, prices, and quality. But no, we insulated them from our economic woes, actually sponsored even greater penetration and market share, created conditions to fulfill their product line strategy, guided them to exploit markets they coveted elsewhere, and made future planning much easier for them.

SUMMARY

There is a revolution occurring in the U.S. automobile market and worldwide auto industry. Stimulated by high fuel prices and vehicle operating costs, and the advent of a competitive market induced by foreign competition, the American consumer has broken irretrievably from tradition. The palaver from auto advertising does nothing more than heighten nameplate awareness. Even though themes have shifted from elegance and style to product and technology, the automotive consumer is bored with appeals so similar and repetitive. For their next purchase, they are shopping around more, and relying on their own experiences with their vehicles, along with the advice of friends and relatives.

What has happened to automotive consumer loyalty demonstrates the upheaval in the U.S. marketplace. Overall, only 23 percent of domestic car owners indicate they would stick with their chosen company. GM's X-, J- and A-body cars are examples of how a lack of differentiation has served to eradicate inter-divisional loyalty.

Compared with the 1950's and 1960's, GM has simply lost its repeat clientele. Our Customer Satisfaction Index shows that only 36 percent of 1981 Cadillac owneres say they would definitely buy another Cadillac. Twenty-seven percent of Oldsmobile owners say they would buy another Olds. For Buick, it's 22 percent.

Other domestic automakers fare even worse. Twenty-three percent of AMC owners say they would stick with the company's product lineup. It's 22 percent for Ford and 21 percent for Chrysler.

For imports, 32 percent of their owners are loyalists. The best of the imports is Mercedes-Benz, with 59 percent of the sample saying they would definitely buy another Mercedes. Forty-six percent would definitely stay with Honda, 45 percent for BMW, 42 percent for Volvo and 40 percent for Toyota.

The Automotive Consumer Profile shows a similar lack of loyalty or adherence to the body style or vehicle type buyers already own.

In the 1950's and 1960's there was a high degree of loyalty among body styles, i.e. a station wagon owner would generally buy another station wagon when it came time to purchase a replacement vehicle; a pickup truck owner would naturally replace his pickup with another pickup; a four-door sedan owner would stick with a four-door sedan, etc. This loyalty was a stabilizing influence on the car market and allowed the automobile manufacturers to predict sales mixes with some degreee of certainty.

Today only twenty-six percent of station wagon owners would stay with a wagon, 2[illegible] percent of pickup truck owners want another pickup, only 18 percent of van owners will stick with a van again, and 13 percent of the sports/utility crowd will buy a similar vehicle in their next purchase.

The fact that potential automobile buyers have fundamentally altered their predispositions and behavior is already affecting the products being offered to them and the way they are sold. The retail end of the industry must change too, since car dealers must contend with this new consumer.

In this context, the futility of market intervention by the federal government is readily apparent for it impedes inevitable forces at work, and would, whether the remedy is local content requirements or continunace of import restrictions, damage the economy needlessly.

Chairman **Gibbons**. You know, Mr. Hemphill, you are the finest thing that has happened to my own personal ego in a long time. Because I really thought it was me. I had begun to wonder about my objectivity in all this, after having listened to my good friend from Pennsylvania, Mr. Bailey, for so long.

Now I find out I am really not imagining these things.

Mr. Bailey, he is all yours. Why don't you take over.

Mr. **Bailey**. Thank you, Mr. Chairman.

I am delighted to state on the record that I never questioned your objectivity, but disagreed with a few of your conclusions.

Chairman GIBBONS. I question them at times because I am trying to be objective.

Mr. BAILEY. I didn't question it. I don't think, you know——

Chairman GIBBONS. Aren't you surprised by this, Mr. Bailey?

Mr. BAILEY. No.

Chairman GIBBONS. You are not? This report I am talking about? That he just read to us?

Mr. BAILEY. Well, you know, Mr. Chairman, maybe this issue of objectivity, before we get too subjective, maybe questioning of this fellow ought to be postponed. I am not a bit surprised about this.

I am very curious. I don't think there is a Congressman down here, I don't think there is an American policymaker, I don't think there is anybody in the news media, I don't think there is anybody in terms of perception of quality in this country, it is a great and free one, that does not raise some of these same questions that are raised here.

Incidentally, I would like you to please do me the favor of delivering to my office or get in the mail very, very quickly your survey.

I would like to see the representative sample. I would like to see how the questions are drawn, what they say and that type thing, because, as we all know some of the difficulties, sometimes, are with credibility and perceptions. I don't have any difficulty with that at all.

Mr. Chairman, a fellow by the name of Nader once did a great perception job on a car called the Corvair. You did not do any survey research on that one, did you?

Chairman GIBBONS. I wish he had done it before I bought it.

Mr. BAILEY. There are clubs around the country of people still dedicated to them. At that time, Japanese quality was not any better.

Chairman GIBBONS. I thought it was a great car until one day I found out I was going backwards down the road, it spun around.

Mr. BAILEY. Well, you have terrible luck, Mr. Chairman. I will try to buy you a nonlemon somewhere, do some shopping with you. See if we can buy a decent car made anywhere in the world.

Chairman GIBBONS. I don't buy anything but American products.

Mr. BAILEY. I am glad to have that on the record. I am glad to know we have some loyalty left.

I am not the least bit surprised. I will tell you what disturbs me about your testimony. I am going to be very honest with you.

It is making the jump, and because I do not have anything else available to me right now, I will give you the advantage of these perceptions, as you call them.

I don't question that. We had Doug Fraser before the committee yesterday. He was talking about perceptions on quality and durability, for example, that kind of thing. You may be familiar with the history of Chrysler Corp., the fact that they made a very, very strong effort in the late 1950's and 1960's to establish a reputation for warranty and quality control in the industry that exceeded everyone else.

The difficulty was people did not want to keep a car that long, as you know. Those are consumer preferences.

People were not interested in keeping an automobile that lasted that long. If you talk about an investment made in durability, I could sit down and debate with you.

I am searching for the information of a study I have seen on durability that indicated across all manufacturers roughly, very small, but about a 7-percent American edge in durability.

It included things like rust resistance. You mentioned yourself in your testimony a comparison in terms of buyer preference on delivery.

And you integrated that with issues, for example, like safety. Those may indicate first-buyer preference. They can indicate all kinds of things.

What bothers me is the jump you make. That is why I am concerned about your objectivity. And I don't want you to take this personally. That is the jump you make to a bunch of policy considerations that do not necessarily connect with the issue of consumer preference or consumer perception.

That is what bothers me. I would suggest to you that I have no reason to question those things. Take an automobile like Mercedes-Benz, for example, for God's sake, what you pay for it, it better top that list.

If it does not, you know——

Mr. **Hemphill**. It did not last year, by the way.

Mr. **Bailey**. Well, I don't know. But I have a real problem with that. I do an awful lot of over the road. I am like the chairman here, I prefer a heavier American car. I would not name a brand, but I like a heavy American car, certainly not the high-price range, but one with dollar value is what I want. Let alone the fact that I do have certain feelings for this country which are very important to me, especially when it is being treated unfairly with a big open world market. As you get into that very simplistic analysis of this problem, I think, I could feel differently and back up some of your policy recommendations which you extrapolate, without really getting to what those issues are.

They are different than consumer preference. A bright fellow like you, I think, recognizes that and knows what point I am making. But I would just say that when I go out and buy that American automobile, I could not replace that dollar for dollar in value, I have got over 100,000 miles on the one I bought a couple years ago, 3 years ago.

There is not a foreign car made that would give me that kind of over-the-road durability, mileage, et cetera, for the things that I want.

No comparison. They do not even make one in that dollar range that could come close, particularly when it comes to the issue of comfort and a lot of long over-the-road driving.

So I think we could argue consumer preference. There are 435 Congressmen in the House. They represent roughly a half a million consumers apiece. If this bill were on the floor in terms of policy considerations, and God forbid the trade approach this country ever makes if the country becomes fully informed of what other nations' policies are in terms of market cooperation between institutions and their so-called private enterprise in Government, et cetera, you are going to see this protection nicely unleashed. And you are not going to see retaliation from some of our friends overseas. You are going to see maturation and meeting halfway.

You let us make the investments we have got to make, my friend, if we follow the same policies maybe some other folks have followed, we will lay that car right on your doorstep, much better and a lot cheaper.

I would like to see that study. I don't know if safety was in there, how much it is stressed, I don't know what you asked.

Let me finish with this. Who are your clients? Who contracts for your services, would you tell me?

Mr. HEMPHILL. Well, first things first. The study that you are referring to in here was subscribed to so far, I believe, at last count, we had about eight or nine manufacturers subscribing to it, two of which were domestic companies.

At least two were European and the rest were Japanese.

Mr. BAILEY. How many, nine?

Mr. HEMPHILL. I think we have eight or nine.

Mr. BAILEY. Eight or nine subscribers to date.

Mr. HEMPHILL. Yes.

Mr. BAILEY. I do not want you to be afraid I am going to try to challenge your credibility. I am not. I do not want you to have that fear.

But I don't like the jump you made from the study to policy recommendations. I think anybody that looks at that statement that cannot catch that transition has a perception problem, incidentally, which ought to be surveyed.

But you say there are two European, two domestic. What is the history of subscribers for your services, your consultations, would you tell me that?

Mr. HEMPHILL. The subscribers over time to these studies have been, I would say, by and large the Japanese companies, the reason being that they do not have the market research departments that the domestics have.

Mr. BAILEY. Could I ask you a question on that, sir? The Japanese companies that subscribe for your services, do they use that information to make advertising decisions, do you know?

Mr. HEMPHILL. I have no idea. I know in some cases they have used it to work on their dealers' servicing problems, to improve product quality.

In some cases, they might use it for advertising purposes. That is entirely up to them.

I would suggest something else, though, since you question the nature of the study. I will be happy to send a sample——

Mr. BAILEY. I don't question it. I really do not know. I just want to look at the questions. I want to see what was asked.

Any of us in the political business knows that nine-tenths of what you get for an answer is what you ask for a question. You are obviously schooled in this kind of thing, know full well that that is one of the greatest problems of polling.

I have no reason to question your credibility. I just want to see it. I want to see the nature, tone and set of those questions.

You say over time you have largely been doing this kind of work for Japanese manufacturers.

Mr. HEMPHILL. Wrong. No, that is incorrect.

Mr. BAILEY. Correct me.

Mr. HEMPHILL. The study is funded entirely by our company, designed by our study, executed by our company.

Mr. BAILEY. Do you sell the results?

Mr. HEMPHILL. The results are available to anyone.

Mr. BAILEY. Do you sell the results?

Mr. HEMPHILL. Absolutely.

Mr. BAILEY. You sell them to who comes to you. You are private enterprise, a business. You sell these results.

Mr. HEMPHILL. Sure. This particular study cost, I think it is $17,500 for the full study.

Mr. BAILEY. You surveyed 7,500 people at a cost of $17,500 on the entire work?

Mr. HEMPHILL. Oh, no, that is what it would cost any subscriber to purchase a copy of the full results of the survey.

Mr. BAILEY. I feel better. That helped your credibility there immeasurably.

Mr. HEMPHILL. The other thing is that we are not just measuring perceptions, we are measuring owners' actual experience with the cars they buy.

Mr. BAILEY. Yes, I know that. Let me say this to you. I do not like to be rude to anybody until they are rude to me, I guess.

I have a tendency to fight back maybe a little bit too hard. I don't know how accurate the perception of quality out there is.

I think in terms of certain models, I would not question it. In terms of others, I would.

In terms of safety generally I don't. In terms of durability, in most cases, I really do not.

I come from the Northeast, hilly area, we salt the roads a great deal, that is why I would like to see the graphic distribution of our study, also.

There is no question in my area of the country on durability. That is something that most people there seem to respond to or seem to know.

The body of an American automobile lasts longer and there seems to be some knowledge of that that is generally out there in the public.

But I don't know. I don't know what perceptions are tied to advertising. I don't know how accurate they are.

So I would appreciate looking at the study. For the chairman's benefit, I do not question the study. I have no reasons to.

But I don't think that is the issue here.

Chairman GIBBONS. You know, you excited my imagination.

Mr. BAILEY. I did not cite it, Mr. Chairman, you did.

Chairman GIBBONS. Last evening, I had a conversation with a Member of Congress, I will not identify him further than that, I will give you the name privately, who told me he owned a brand new 1982 Oldsmobile and the transmission went out completely before 3,500 miles.

Now, my transmission has got 4,000 miles on it. So you know, mine is working fine. It is just the tar that I am having trouble with.

Mr. BAILEY. Let me tell you what I will do. I will invite you to write to the industry.

Chairman GIBBONS. This is not a fast-driving Member of Congress, either.

Mr. BAILEY. I don't know how fast a driving Member of Congress I am, but I have a friend named George Kearnes that lives at 522 North Maple Street in Greensburg, Pa., who owned a Datsun.

I can go on all night with this. I do not care. I can tell you his experience with a Datsun, his hand went through the fender. Then I can tell you what his experiences were with having that fender replaced. I can go into innumerable accident situations.

Chairman GIBBONS. I cannot top that, but I can tell you my Chevrolet fan went through my radiator. I have the bill to prove it.

Finally, you know, Chevrolet recalled it after a year and a half. You know what they did? They strapped the engine into the car with a piece of cable.

Mr. BAILEY. Well, I think that——

Chairman GIBBONS. So you know——

Mr. BAILEY. We could go on with endless discussions and retorts and rejoinders concerning individual experiences with American versus other cars.

Chairman GIBBONS. I have another one that will top even that.

Mr. BAILEY. Well——

Chairman GIBBONS. I own a 1968 Chevrolet Camaro, brand new, bought it right here in Washington. Could not ever get the thing to run. I took it back to the dealer.

The dealer said, "Go take it someplace else." So I did. I came in and exercised my congressional prerogative. I called up the president of General Motors and said, I have a car down here that nobody can fix.

Oh, Congressman Gibbons, we will be glad to send somebody down there to see your car. So one day about a week later a fellow appeared in the Cannon Building, that was a long time ago because I was over in the Cannon Building, and he came in, introduced himself, a nice fellow.

I said, well, I got it started this morning. It is downstairs in the Cannon Building garage. I said, here are the keys. Go out and see what you can do with it.

He came up about 15 minutes later kind of ashen-face and said, I have to call the wrecker, Mr. Gibbons. This car had about 700 miles on it. It would not run.

He had to get it towed out of the Cannon Building. It runs. They finally got it running. So you know.

Mr. BAILEY. Well, I want to respond to the issue of quality control.

There is no doubt in my mind, I have never seen it denied, I have never seen anyone question the fact that the American automobile industry, which is very much capital-starved and very much trying to make a technical changeover, is going through some very painful reinvestment decisions.

I think that the union is with them.

I am very familiar with that, Mr. Chairman, and I don't question at all the fact that, across the board, if you said how many repairs are you going to have to do in a year on a new automobile, in other words, giving you the benefit of the doubt, getting away from my safety and durability arguments and say, gees, I would not doubt that a good solid study would support that.

I don't really know if that is the question. I think there are many, many deeper questions here, many, many different causes and that kind of thing.

I would only say this to you, Mr. Chairman. I deeply respect and admire you because of the loyalty that you are maintaining in the face of what you accept as a reality; that is, the apparent belief of superiority, and it must be a massive superiority.

In fact, I am astounded at this. This indicates, in light of the statistics I just heard from you, that we are doing even better, they are wrong, our cars are even worse.

I just hope that we do not give up on them and sort of let them die away. And I hope that we stick with them.

Chairman GIBBONS. Well, you know, I would not care if they did not come in here and——

Mr. BAILEY. And I really admire you for sticking with American automobiles. I do. I admire you.

Chairman GIBBONS. I appreciate that. I would not mind if they would come in here and say, you know, we have done a lousy job. We have to cut the salaries of the management and we are going to talk to the workers about getting their salaries down to something near reasonable. And we are going to try real hard.

But you know they have not. They have not done that.

Mr. BAILEY. Mr. Chairman, you know we are talking about——

Chairman GIBBONS. They gave up their bonuses.

Mr. BAILEY. If we are talking about objectivity and subjectivity and really solving the problems of this industry, you know full well that those things that you are saying do not really relate to this very well as a policy issue and as something that gets at the cause of the problem.

Now, you know, with all due respect, you and I have gone through this debate and I do admire and respect you, I do, and I have a great deal of affection for you, I think——

Chairman GIBBONS. I can tell that.

Mr. BAILEY. No, but I really do. I honestly do. I think you are one of the kindest and most well-intentioned persons I have ever known, and I mean that.

You have been awfully nice to me and I know we disagree so much. And I really admire you for that. I don't know if I would have your patience with me, given the power you have as a chairman.

But I just think that this issue of management changes and labor package and everything can be overdone.

There can be some just criticisms there. I don't share it. I think they are honest differences of opinion.

But it does not really solve the problem and get to the issue of what is involved here. There are much broader things.

I don't know an advocate or a cosponsor or an originator of this legislation that views it as an ideal response in any stretch of the imagination. Everyone has openly and honestly admitted that.

That it is not something that they want to see, but it is something viewed in the context of a necessity to try and teach a lesson.

Mr. Dannemeyer testified about the immediate nature of the legislation. We know it takes a long time before it is implemented. We looked at the productivity figures.

I have studied them very closely. I would not stick my neck out that much. I think if we do the work on reinvestment in this industry, we know we have some structural unemployment changes to be made.

I will say right here and right now, we could pay those wages and better, and produce a higher quality and cheaper automobile. I am confident in our industry's ability to do that.

But I am not going to blame labor unions and industry leaders for things that I, in my heart, just do not believe are true.

I just do not believe it is a correct criticism. I think it is overdone. And I will buy American. And we will win. We will win.

Chairman GIBBONS. Mr. Pease.

Mr. PEASE. Thank you very much, Mr. Chairman.

Sir, I appreciated your testimony. I would like to ask you just a couple of questions.

Do you get into the reality in your surveys, or just into the perceptions?

In other words, people perceive that they have more trouble with service or whatever. You are just asking perceptions, or do you find out whether it is really the case or not?

Mr. HEMPHILL. On the survey where we sampled the 7,500, 22 nameplates, of customer satisfaction, and I will be happy to send a copy of the questionnaire so you can see the detail with which we approached this problem, it is a six-page typeset questionnaire that covers everything from purchase process to warranty work, type of warranty work, to delivery problems and type of delivery problems, to return visits they made to the dealer, were they treated courteously, uncourteously, did they have to wait for parts, how long did they have to wait, what kind of parts.

It is self-report on the part of the consumer, to be sure. But it is their own experiences with the car that they bought during that first year of ownership.

Mr. PEASE. When Mr. Fraser, from the UAW, was here yesterday testifying, he said that he thought American cars were superior in several respects.

He mentioned rust, better resistance to rust. He mentioned stronger, better and more durable power train. He mentioned specifically safety. And he mentioned the long-term durability of American cars as, in his opinion, being superior to those of Japanese cars in particular.

Does your survey cover things like that?

Mr. HEMPHILL. We do not cover consumers in survey work that have owned their car, let's say, beyond a 2-year period. We are aware of studies on durability and read them.

That is really not our business to look at the 10-year-out owner group as the thrust of our business.

Mr. PEASE. Why would that not be of interest to your clients? Wouldn't Toyota be interested in knowing what people's perceptions are of the safety of their cars or long-term durability or whether the bodies are going to rust out after 4 years?

Mr. HEMPHILL. Yes, and they do owner surveys. Mostly that is a part of our customer research that we do for clients. Not the syndicated research. In other words, we have companies that come to us and say, survey our owners of 4-, 5-, 6-, 7-, 8-year-olds, but those are proprietary to the clients that ask for them.

Now, in safety, we do regularly ask what attributes are sought in a car and we have some eight or 12 attributes that they rank order for us.

Currently, they are saying it is dependability, trouble-free operation.

And about 10- or 12-percentage points below that and clustered closely are things like purchase price, fuel economy.

Then comes styling, passenger comfort, on down. We compared safety concerns of Japanese-manufactured carowners to comparable-size American carowners to see how safe they feel with their purchase.

Mr. PEASE. What are those results?

Mr. HEMPHILL. That the Japanese owners feel as safe as their counterparts in domestic automobiles, by and large. Wishful thinking or not. That is there feeling.

Mr. PEASE. Those feelings sort of contradict the studies that have been made by scientific organizations, do they not?

Mr. HEMPHILL. Indeed, they do. But I would submit to you that the studies, for example, that the Institute for Highway Safety published had two fundamental flaws.

One of them was that they did not correct for the driver age group driving the vehicles, nor did they correct in their findings for the vehicle miles traveled per vehicle.

The Japanese cars are driven on the average of about 25 percent greater distances each year than domestic cars.

Mr. PEASE. Within the United States?

Mr. HEMPHILL. Yes.

Mr. PEASE. What would be the reason for that?

Mr. HEMPHILL. Primarily the younger-age profile. It is about an 8- to 10-year difference on the median between a domestic and a Japanese driver, so they are more mobile.

Mr. PEASE. These are basically younger Americans who tend to buy Japanese cars in great numbers?

Mr. HEMPHILL. Yes. Don't hold me to this. The median age of domestic buyers, around 40 to 42, new car buyer. For Japanese it is about 10 years less, 9 to 10 years younger.

Chairman GIBBONS. That really spells trouble in the years ahead.

Mr. PEASE. It seems to me that when we ask about perceptions of satisfaction through the first year, American cars come out to a disadvantageous position. But I wish that you could have asked the questions about the longer run, because my suspicion is that there Fraser is right, and that that might make the picture look better for American cars. But when you only ask questions about the short run, people who have owned the car for say 15 months or less, it disadvantages American cars.

Mr. **Hemphill**. But, Mr. Pease, it came up this morning earlier with Dr. Rivlin, and I think Chairman Gibbons queried her on the subject and she really didn't know. I would like to offer some insights on this question of the importance of durability and the importance of the longevity of the cars for the new car market.

In a way I think that the doldrums that the car market in general has been in for 3 years is giving, is casting a gloom over all of these proceedings. The fact is that buying cycles have not been altered that greatly. As we have for 3 years, if you ask consumers how long they expect to keep their vehicle, it varies between 3.5 to 3.6 years. That has not changed one bit in 3 years, which suggests to us that people will be coming back into the car market, perhaps not on a 3-year cycle, maybe closer to a 4-year cycle because of prices and financing. But they are going to be back.

The other thing to consider here is that the market is not down for good. The market is coming back. This was another question Dr. Rivlin was addressing this morning. The car market is going to be a very healthy one. It is not going to be just a replacement market in this country. We have a 14 percent increase in licensed drivers entering the new car market during the next 7 years. We have households being formed faster than the population rate is increasing. We have more and more dual income families with greater needs for personal transportation. We have migration to the Sun Belt that doesn't have mass transit, and the need for personal transportation would grow.

The ratio between licensed drivers and cars today is approximately one-to-one. We don't expect that to change very much. But the need for personal transportation there and the demand is going to be there. We wouldn't find it at all surprising next year to find a 12.5 million car sales annual rate being achieved sometime next year. All the demographic factors are there. It is hard to build a case for not having a good car market in this country in the future.

Mr. **Bailey**. We better move quickly.

Mr. **Pease**. Your position is that it is inadequate income on the part of Americans, the recession is keeping cars from being purchased?

Mr. **Hemphill**. Absolutely.

Mr. **Pease**. Not a lack of basic desire.

Mr. **Hemphill**. And their concern over the price of the cars.

Mr. **Pease**. Thank you very much.

Chairman **Gibbons**. Mr. Vander Jagt?

Mr. **Vander Jagt**. Mr. Chairman, I merely would like to thank the witness for extremely interesting testimony.

Thank you very much.

Mr. **Hemphill**. Thank you.

Chairman **Gibbons**. Thank you, sir. Very fine.

Mr. **Hemphill**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Appreciate your coming all this way to help us with this problem.

The next witness is Consumers for World Trade, Doreen Brown, president, and Phillip H. Trezise, member, Board of Directors.

STATEMENT OF DOREEN BROWN, PRESIDENT, CONSUMERS FOR WORLD TRADE, ACCOMPANIED BY PHILLIP H. TREZISE, MEMBER, BOARD OF DIRECTORS

Ms. **Brown**. Thank you, Mr. Chairman.

As you know, we are a national nonprofit organization and we conduct educational programs to keep American consumers informed of their stake in international trade policy and speak out for the interests of consumers when trade policy is being formulated.

Consumers for World Trade opposes the Fair Practices in Automotive Products Act, H.R. 5133. This legislation would do two things to the American consumer: It would raise prices; it would restrict his freedom to buy what he pleases. These are predictable, certain results.

In the first instance, the bill would create an artificial scarcity of automobiles that demonstrably have met the demands of a great many consumers. In effect, it is a bill to set import quotas. The version before this subcommittee would establish domestic content requirements to be reached in stages over the next 3 years. There is no practical way for the higher targets to be met by foreign producers during this short period. A severe reduction in imports would be forced on the market. Prices of imported cars would rise. Prices of domestic autos would follow them up.

If I may add a thought not included in the written testimony, American consumers have just borne the price increases resulting from the Japanese voluntary restraints agreements. Any additional increases in prices would certainly act as a disincentive to purchasing new cars thus exacerbating the domestic industry's problems rather than alleviating them.

How great the direct price impact would be depends on assumptions about the state of the economy and the various responses of foreign and domestic manufacturers to the new situation. Under no conceivable assumptions would it be trivial. That would only be the beginning. The bill would impose rigid content requirements on the Big Three. No matter what opportunities were available to cut costs by investment and procurement abroad, these producers would be chained to a fixed domestic content ratio. American Motors and Volkswagen of America would see their domestic content ratios rise if their sales rose.

In its treatment of the American manufacturers, the measure therefore aims at a kind of freeze of the status quo. The effect would be to restrict possibilities for advances in efficiency through further international specialization. This reflects a Great Wall of China philosophy. As always, the consumer would be the ultimate victim.

Proponents of H.R. 5133 say that it would promote foreign investment here. To a small degree it probably would, as some foreign producers might find it feasible to meet the lower ratios that would apply to lower-volume sales, particularly as American car prices escalated. Consumers, however, can hardly find any cheer in the prospect of foreign investment that is forced by American statute rather than induced by normal market considerations. It will be another cost-raising development.

Looking ahead, how many other industries will be singled out for similar legislation? Imports of manufactures were running at an annual rate of $138 billion in this year's first half. If a domestic content rule is good for autos, why not for all transport equipment? Or for all durable consumer goods? Or why stop with manufactures? For example, mixing regulations could be placed on the domestic coffee industry to assure a suitable share for roast barley in our breakfast blends. For consumers, the precedent that would be set by the present bill is a truly discouraging one.

Then there are the costs of foreign retaliation. H.R. 5133 is in direct violation of article III, paragraphs 1 and 5, of the General Agreement on Tariffs and Trade. Our trading partners have a clear legal right to retaliate. It is not believable that the right would not be exercised. Once again, the price in distortion and disruption of existing trade patterns would be paid in the end by the consumer.

In fact, the danger here is considerably greater than a first round of retaliatory trade actions. The United States would be deliberately savaging the GATT at a time when the whole trading order is already at risk. A lapse into general anarchy, such as we had in the 1930's, is no longer so farfetched an event. We could move the trading world perceptibly further toward it with the wide breach in our GATT commitments that would be represented by the measure now being considered. There will be few winners from that.

Finally, H.R. 5133 proposes to take away from Americans the right to buy an automobile of their own choice. If this law said straightforwardly that only a select few consumers could buy a Toyota or a Datsun, the Congress would surely reject it. Dressed up as a domestic content bill, it has acquired substantial support. Nevertheless, it remains a large scale intrusion on everyone's freedom of choice. All American consumers should vigorously oppose this legislation and the Congress should refuse to enact it.

Chairman GIBBONS. You are right.

Mr. Bailey?

Mr. BAILEY. You are wrong. I yield back.

No; I do have a couple questions. I don't agree with some of your conclusions, but I probably agree I think with some of your goals. Are you a worldwide organization?

Ms. BROWN. No, sir. We would like to be but we are not. We are a national organization.

Mr. BAILEY. Consumers for World Trade.

Ms. BROWN. American Consumers for World Trade.

Mr. BAILEY. American Consumers for World Trade. You don't have a chapter in Japan?

Ms. BROWN. No.

Mr. BAILEY. Incidentally, I am not going to attack you on the credibility of your funding and that kind of thing; you may be pleased to know that. I will deal with it on the merits. I know there have been suggestions raised about who you work for and who pays your bills, and that kind of thing. But I don't think that is germane to what I want to ask you here.

You do not have folks, or a chapter or any organization in Japan?

Ms. BROWN. No, we do not.

Mr. **Bailey**. Do you have knowledge, personally, of the way, or reasons or any ideas on why we have come to this point in time and find our American industry in this kind of competitive position?

Ms. **Brown**. In this kind of noncompetitive position?

Mr. **Bailey**. Well, poorly competitive position.

Ms. **Brown**. Yes.

Mr. **Bailey**. Whatever adjective you would like to use.

Ms. **Brown**. I have an opinion that I think has been suggested by many others.

Mr. **Bailey**. Yes.

Ms. **Brown**. Many of the problems are due to the current tone of our economy; as well as the lack of concern at a time when our economy was in a better condition, by our large domestic industries to really consider domestic wants, consumer needs and wants——

Mr. **Bailey**. You use the plural "industries," so you would include steel, mining——

Ms. **Brown**. I thought you used the plural——

Mr. **Bailey**. No, I mean you became general.

Ms. **Brown**. Referring directly to the automobile industry, then I think a lack of concern at a time when there didn't need to be, when our economy was better, of what the consumer wants and purchasing patterns were. By the time they did get around to that it was awfully late in the game, obviously.

Mr. **Bailey**. Our companies?

Ms. **Brown**. Our domestic companies. A lot of other things. Once the domestic companies were in difficulty, then obviously imports became a problem.

Mr. **Bailey**. Became an overwhelming one.

Ms. **Brown**. Normally a healthy competitive industry should not have to worry. But it is not the imports that created the original problem.

Mr. **Bailey**. Do you think it is American industry that created the problem, management——

Ms. **Brown**. I think it is the general economic conditions and the American industries themselves to a great degree which were not paying enough attention what the consumer was buying and what the consumer wanted.

Mr. **Bailey**. Are you familiar with the history of the Japanese automobile industry and its relationship to the Japanese Government?

Ms. **Brown**. Yes.

Mr. **Bailey**. And/or the policy of the Japanese government?

Ms. **Brown**. To a degree. Ambassador Trezise is even more familiar than I am with that.

Mr. **Bailey**. Do you have any views on that as an organization? I mean simply going out there today and following what the chairman has touched on, and purchasing the most, according to the gentleman who talked on survey perceptions, if those perceptions are accurate, if you want to go out and buy the most high quality, cheapest piece of transportation, according to what, you know, you should have this choice according to you, uninhibited in any way. I suppose that is a nice ideal. And according to the gentleman who just spoke earlier it would be a Japanese choice apparently if it went according to statistics or perceptions.

I don't know if that tells the whole story. I don't know if that speaks for free enterprise. Are you free enterprise oriented?

Ms. **Brown**. Yes.

Mr. **Bailey**. Are you familiar with free enterprise in Japan as practiced?

Ms. **Brown**. I am not an expert on it.

Mr. **Bailey**. You would not recommend that we approach our industry the way they have, which has been a highly successful industry apparently on their part?

Ms. **Brown**. No, I would not. I think that if you are going to pursue what you term "ideal" and what we term "a realistic future and a healthy future", we should not be trying to approach it by using methods which are going to further close or impede an open flow of trade. I think we would be biting off our nose to spite our face. It is fine to say "they are doing it, why don't we," but it doesn't work that way, you know. Trade barriers multiply once the momentum gets going.

If the automobile industry suddenly gets a little bit better in a very short time, that is when everybody else is going to jump on the bandwagon. This is obviously not a philosophy, we agree with, and we hope that this country does not. It is not the way which will eventually lead to a healthy economic international situation.

Mr. **Bailey**. I want to say this to you. I happen to agree that as a policy alternative this is one that I think is probably passable politically. I think that is unfortunate in a sense because I don't think it is the best way to proceed. I would much rather look to some of our trade alternatives. This becomes an important part of the trade thing, I think, world perception. I also would rather look at our tax and regulatory structures for these kinds of solutions, because I think we need a refurbishing of plant and equipment in our country—and not just the automobile industry. We need to direct, I think, some more resources in that area.

I probably come off very much sounding like I am anti-Japanese. I don't feel that way, but I am very much "anti" what they are doing with their system. I also wish they would be wise enough to respond to the fact that there is a world that is going to react very angrily to the way they pick and choose and target markets and industries and that kind of thing. There is a lot of reaction going on worldwide to them that does not serve the free world. It does not serve free enterprise. It does not serve world peace. It does not serve world trade objectives, which are more free and open trade.

Now what do we do?

Ms. **Brown**. You are asking me for the solution?

Mr. **Bailey**. Yes.

Ms. **Brown**. I didn't come prepared with a solution. If I weren't so busy fighting protectionism all the time, I would be sitting down figuring out solutions to our problems. I don't have a specific solution. I know the areas to avoid. I know the way not to go. I could fudge about a solution by saying the obvious. We need to work toward improving the economy; we need to not lose our leadership and the example we are setting as a more open market than any other country in the world—not a totally open market but certainly a more open market. I think it is terribly important that we hang onto that and not give in to the temptation of protectionism.

Mr. BAILEY. But not demand it in others?

Ms. BROWN. Yes, certainly we must demand it. And we do demand it. We are certainly negotiating demands constantly. We certainly demand that American statutes be obeyed. And if they are violated, that we go through the process established by the GATT and our own Trade Act. We demand that the GATT agreements be strengthened. We certainly demand that our trading partners respond to the open trading system. That isn't what we are arguing about. What we are saying is, will our way of thinking bring us closer to this ideal world of yours, or is your way a better one.

We happen to believe that your way, or the way suggested by you and others, is a very dangerous and ineffective way to solve the problem.

Mr. BAILEY. I have wrestled with that problem myself. I would only say that before we become a nation of a vast multitude of different categories of structural unemployment problems, we had better find some way to respond.

Thank you, Mr. Chairman.

Chairman. GIBBONS. Mr. Pease?

Mr. PEASE. Mr. Chairman, I have no questions.

Chairman. GIBBONS. Mr. Vander Jagt?

Mr. VANDER JAGT. No questions. We thank you very much.

Chairman. GIBBONS. Thank you very much for coming.

Mr. Pease, would you preside long enough for me to run over and make a quorum for a conference? I will be right back.

Mr. PEASE [presiding]. Sure.

The next witness will be Harriet Hentges, executive director of the League of Women Voters.

STATEMENT OF HARRIET HENTGES, EXECUTIVE DIRECTOR, LEAGUE OF WOMEN VOTERS OF THE UNITED STATES

Ms. HENTGES. Mr. Chairman, members of the committee, I am Harriet Hentges, executive director of the League of Women Voters of the United States. The League of Women Voters of the United States, a nonpartisan citizen organization, has members in all 50 States, as well as the District of Columbia, Puerto Rico, and the Virgin Islands.

The League of Women Voters welcomes this opportunity to address the domestic content legislation pending action by the House Ways and Means Subcommittee on Trade. We congratulate you, Mr. Chairman, for scheduling hearings on this legislation with the short notice given your committee. At the same time, however, we must express our chagrin over the manner in which this far-reaching trade legislation is being handled by the Congress. We regret very much that the Commerce Committee plunged forward in its deliberations with only 2 hours of hearings, without any real debate or sufficient opportunity for amendment and discussion.

The charge to you to complete consideration of the bill within 8 days provides little time to assimilate and analyze information and to judge its impact on the U.S. economy and U.S. relations with other trading nations. We feel very strongly that it would be irresponsible for the Congress to push through such sweeping legislation in the last few weeks left before adjournment. It is our hope that the bill might be set aside until the new Congress convenes in January, when the measure can be given the kind of deliberate consideration it requires.

The League of Women Voters opposes the use of domestic content requirements in general and as applied in H.R. 5133 specifically. It is our conviction that such legislation would jeopardize America's interest in expanding worldwide trade. Also, by requiring that cars sold in the U.S. market contain a mandated percentage of American-made parts, it would have virtually the same effect as auto import quotas, thereby raising consumer costs and limiting consumer choice.

We believe that there are substantial reasons for rejecting H.R. 5133:

Domestic content requirements are expressly prohibited in article III of the General Agreement on Tariffs and Trade. If domestic content becomes law, GATT signatories can be expected to seek compensation for lost exports to the United States in excess of $15 billion.

The proposal would be tantamount to an absolute import quota far more restrictive than the current "voluntary" Japanese import limitation. As approved by the House Commerce Committee, H.R. 5133 would require new cars sold in the United States to have a certain level of American-generated domestic content, based on a formula related to the wholesale price for cars sold by a foreign or domestic company. Any foreign company not meeting the domestic content standards would have to cut back its auto exports to the United States by an amount equal to the proportion of that percentage in the following year. These requirements would therefore have the same practical effect as auto import quotas. In fact, it is difficult to see how the domestic content bill could possibly be enforced without formal quota restrictions.

Even more specifically, the bill would undermine U.S. efforts to eliminate domestic content requirements by other nations. No other developed countries except Australia, Greece, and Spain and no country that produces for the world market competitively has domestic content requirements for automobiles. U.S. adoption of such measures invites retaliation that might expand to U.S. exports in agriculture, aircraft, computers, and electronic equipment. And, with 1 out of 7 American jobs in manufacturing dependent on exports, we cannot afford to risk further erosion of our export potential. Moreover, passage of such a law would negate the administration's current efforts to secure trade liberalization measures by other nations, especially Japan and the European Community.

The measure is costly, inflationary, and inefficient and would force auto prices to jump significantly. Domestic content requirements will raise the price to consumers of popular foreign imported cars by as much as 10 percent and will also limit U.S. companies' flexibility to cut their costs by using some less expensive foreign parts now and in the future.

The proponents' claims for the job creating potential of the legislation are highly problematic. If auto sales in the United States were to double by 1985, domestic content laws, according to the Council of Economic Advisers, would create 200,000 jobs at the most in the auto sector—not the 800,000 jobs claimed by the bill's advocates. Also a substantial part of that expansion would be offset by the jobs which would be lost due to potential cutbacks in the U.S. facilities to distribute and transport auto imports: By the closings of foreign car dealerships; by the laying off of port workers who handle auto imports; and by the abandonment of existing U.S. assembly plants for imported cars.

The League of Women Voters has a longstanding interest in world trade going back to the 1920's. We have been consistent and strong supporters of a liberal U.S. trade policy, believing that the political and economic interests of this country and its citizens are best served by such a policy. In addition, it paves the way for political harmony with other nations, stimulates economic development at home and abroad and expands consumer choice. It is not enough to support liberal trade policies in generalities. Support must come in the form of positions taken on specific legislation that either advances or inhibits a more liberal trading system. H.R. 5133 expressly violates international trade agreements, risks the threat of retaliation by our foreign trading partners and severely limits consumer choice. Members of the League of Women Voters, therefore, urge the House Ways and Means Committee and the Congress to reject this dangerously protectionist bill.

Mr. PEASE. Thank you very much. Let me begin by asking one or two questions myself. You say the league has been a consistent supporter of liberal trade policy. Has the league had a consistent position regarding the fate of displaced workers and what ought to be done on behalf of them?

Ms. HENTGES. Yes, Mr. Chairman, we have. We have supported the sections of the Trade Act of 1974 that establish adjustment assistance for workers, firms and communities, and we have consistently, when legislation has come up regarding the funding for those programs, urged reasonable funding for them. We feel that a comprehensive trade policy should address the question of workers displaced by imports.

Mr. PEASE. Very good. You will be happy to know that I have pending before this subcommittee a bill that would expand the training aspect of the Trade Adjustment Act. I am delighted to have the support of the League of Women Voters.

Ms. HENTGES. You'll have it.

Mr. PEASE. Mr. Bailey, let's see what you have to say.

Mr. BAILEY. Rarely anything, Mr. Chairman.

Thank you very much. On page 3 of your statement, the third sentence down, "U.S. adoption of such measures invites retaliation that might expand to U.S. exports in agriculture, aircraft, computers, and electronic equipment." Obviously, the League of Women Voters is not in a business field, and you are not involved. I am not trying to put you on the spot or anything. Are you or the league aware or do you do studies in terms of what the marketing situation is in just those areas you mention?

Let me tell you why I ask this question. People who look at simply the perception of buying in the American domestic economy, I think, have a tendency to recoil at this mechanism, this particular way to go, this legislative route. I share some of that criticism. I, however, feel it is the best alternative and something we need to do in order to let the Japanese nation, the Japanese people and Japanese decisionmakers know that the world is becoming concerned with the particular type of business practices they carry on. They are about people. Japan is a democracy. I am sure she will learn and respond and that type of thing. But we haven't had much success lately.

What could they do to us to retaliate in those areas that you just mentioned, agriculture, aircraft, computers, and electronic equipment?

Ms. HENTGES. Agriculture is one of the areas that we have consistently pressed on the Japanese to open up.

Mr. BAILEY. How well have you done?

Ms. HENTGES. I think we have made some progress. I wouldn't purport to speak for the agricultural community. I am aware of the negotiations that went on, I am aware of the continuing conversations that take place between members of the agricultural community and representatives of the Japanese Government. I suppose how well we have done depends on the measure you choose to use. Are we where we want to be? Probably not. By where we were? Some progress, has been made.

Mr. BAILEY. Let me say this to you. Many Japanese in fact admit in the agricultural area that they have not made anywhere near the progress they should make to open their markets up. We have a lot of people over there that are constrained to disagree with that, the point I just made.

Second, aircraft. Are you aware of the domestic content requirement placed on American manufacturers and marketers in Japan concerning aircraft? Are you aware of a fledgling aircraft industry in Japan and goals of the Ministry of Trade to establish, particularly in the commercial area, that industry as a major world area within about 10 or 15 years? Are you aware of the domestic content requirements in that area for American aircraft companies?

Ms. HENTGES. It is precisely because of the concern we have with the domestic content requirements of other countries and efforts that I think we need to make to urge our trading partners to remove them that we take the position that we do, we are in a very difficult position to urge other countries to remove their domestic content requirements if we enact such legislation.

Mr. BAILEY. If we set a bad example. Then what do we do?

Ms. HENTGES. I suppose that is one way to put it, but it also weakens the position to argue against their requirements.

Mr. BAILEY. We have been arguing against it for many years. What do we do now? Mr. Pease has 50,000 unemployed people in his district. I think I know the gentleman well enough to know, and I don't mean to embarrass him by speaking in his presence here. I know his intellectual depth, I know where his heart is. I know all of us, what we would like to see happen in terms of the world economy. But we have been crying for years. Now finally America has a problem and people are starting to say, look at trade. The public is starting to get aware of trade. What do we do then?

Ms. **Hentges**. I think we continue to negotiate within the terms of the GATT. We have a GATT ministerial coming up where the United States has objectives it wants to pursue. I think it is the question of the mechanisms and tools trade policy that we choose to use to pressure our trading partners.

Mr. **Bailey**. What would you use?

Ms. **Hentges**. The mechanisms of the GATT.

Mr. **Bailey**. Would you use a lawsuit? Do you settle for $11 million?

I can't wait. I am not going to be in the Congress. I wish I were here and an investigation were held of what is behind the dumping cases out in California when we finally get a hold of it, that those suits were settled for $11 million. I have private sources that have told me that for years the dumping, the invoice and criteria, fraudulent invoices and measurements of prices and imported items that were dumped and steel fabricated and steel products in this country, are into the hundreds of millions of dollars. We settle it for $11 million. I don't know what is going to come out of it. I know there are going to be some criminal prosecutions. But what do we do?

Mr. **Pease**. Would the gentleman yield for a minute?

Mr. **Bailey**. Yes, certainly.

Mr. **Pease**. I wonder whether the league would consider supporting a domestic content auto bill to be applied only to those nations which have imposed domestic content requirements on aircraft.

Ms. **Hentges**. I can't imagine that we would support that, because it is not a mechanism consistent with GATT. That is the trading agreement within which we should work.

Mr. **Pease**. There would be no need to impose that, though, unless another nation violated the GATT first by imposing a domestic content requirement on aircraft.

Ms. **Hentges**. It would be a negative retaliation rather than using the mechanism available under GATT.

Mr. **Pease**. I have caught you speechless.

Thank you, Mr. Bailey.

Mr. **Bailey**. You are welcome.

Let me finish by saying this to the league representative. If I could get down on my knees and beg, and I mean this sincerely, the Japanese decisionmakers to see the effect that their practices are having, the reaction it is causing worldwide, I would. I don't fear competition for this country from anyone. I think when we create a situation here domestically, for example, with tax or regulatory laws that make us noncompetitive, we have an obligation to respond. I think our companies should have to compete like anyone else. I share your views. I sincerely do. But I am at a loss to come up with some way to make someone listen.

We have pushed free trade, you are 1,000 percent right. I could get into countless examples in the steel area, one of the best areas. And automobiles is another one.

How is subsidization defined under the GATT? You are probably not aware of that. Maybe you are, I don't know. But if you are you know that different countries and different practices define it differently. You talk about going to the GATT to solve a problem. Everybody who has dealt with a dumping case knows what that is like. In all honesty you know we signed off an agreement in the last MTM that had to do with discovery requirements that affected the ability of private litigants to such a negative degree it rendered the law almost meaningless in my opinion.

Now what are we supposed to do in response to those things? I agree with the league, with where your heart is. I think the goals are things that we share. But we need some alternatives and suggestions. I would simply ask the lady if possible at sometime to maybe sit down with her board and come up with some suggestion on how to make this free trade thing meaningful. It is silly to say the rules for free trade and what it means in the United States should be different than they are worldwide. That is silly. And that is not fair. It is not fair to America.

Ms. HENTGES. Mr. Bailey, I don't think that we are asking that the United States abide by different rules than other trading nations do. We feel that we have an agreement within the GATT with other countries. And we should bring our trade problems to that forum and press within the limits provided by that.

Mr. BAILEY. With all due respect, we have. The enforceability is too difficult as a practical matter, quite frankly, and we don't get much cooperation. No really, it is that simple. You can't get information from foreign governments. You don't get cooperation from their companies. I could talk about a little concept that would bore everybody to death even further, a little thing called downstream dumping, and show you how price increases are passed on to, or dumping at cost protects foreign employment at our expense without violating the law. The law is not adequate. It is not enforced properly. But worse yet, its spirit is not adhered to. That is the worst thing.

And that's the lesson that some of us are trying to teach. I don't like this vehicle. I think you are right. I share that view with you.

Ms. HENTGES. But we would be violating the spirit by this legislation.

Mr. BAILEY. Oh, yes, we are going to violate a lot of spirits before we get this thing straightened out. I respectfully disagree with your position.

Thank you, Mr. Chairman.

Mr. PEASE. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you, Mr. Chairman.

I would like to thank the witness for her testimony and pursue just a little bit the question the chairman was asking. You did express a concern about domestic content rules in Japan relative to the aircraft that we would like to sell. What about if we made this bill discretionary, and said the trade import restrictions do not need to be applied whenever the President finds that the other country is cooperating with us in trying to reduce trade barriers? Don't you think it would give much greater punch to our negotiating ability if the President had this discretionary authority, which he wouldn't have to use, and wouldn't we be likely, more likely to be successful in getting Japan to get rid of its domestic content legislation, which is the goal that the League and many other people share?

Wouldn't we move more rapidly and effectively toward a more free trade world?

Ms. Hentges. What you are suggesting is instituting a tool that you would not want to be used.

Mr. Vander Jagt. We would hope it wouldn't be necessary.

Ms. Hentges. The difficulty I would find with that is that something we could consider illegal under the GATT would be introduced. The fear is that it would be used. It may be giving the President a tool he wouldn't want to use.

Mr. Vander Jagt. I think your answer is a very good one and I think it goes to the heart of the matter. But couldn't we just say: "Japan, if you will stop doing what is illegal, then we won't have to start doing something that is illegal"? Wouldn't that be a happier world?

Ms. Hentges. I would question whether it would achieve the results that we want.

Mr. Vander Jagt. Thank you very much. Your testimony was excellent.

Mr. Pease. I thank you very much. We have another vote on unfortunately. We have one more witness. I think we will go and respond to the rollcall and declare a recess of about 10 minutes.

[Recess.]

Chairman **Gibbons** [presiding]. Our concluding witness for the day will be representing the Council for the Advancement of Consumer Policy, Mr. Martin Petersen, chairman of the board.

Mr. Petersen, we welcome you and you may proceed as you wish.

STATEMENT OF MARTIN R. PETERSEN, CHAIRMAN OF THE BOARD OF TRUSTEES, COUNCIL FOR THE ADVANCEMENT OF CONSUMER POLICY

Mr. Petersen. Thank you, Mr. Chairman.

I am Martin Petersen, chairman of the Council for the Advancement of Consumer Policy. I will abbreviate my prepared remarks in an attempt to keep within my time limit.

Chairman **Gibbons.** Yes, sir. Your statement, and all other witnesses' statements, will be included in full, as if presented that way, in addition to their other remarks.

Mr. Petersen. Thank you, Mr. Chairman.

The council was founded in 1979 to serve as a nonprofit "think tank" for consumer affairs. We do not claim to represent "the consumer," as the self-interests of individuals are too divergent. Policy at the council is set by its board of trustees to contribute to and advance concern for the consumer through the stimulation of a competition of ideas.

Our work in the international trade area indicates domestic content requirements, or any other form of quota, tariff or nontariff barriers for automobiles, are not in the public interest for the general welfare of the American consumer.

Over the last 3 days you have heard a great deal about the creation of jobs, displacement of others in the job market, the health of industries, frustration with Japanese trade practices, and historical and projected cost-and-benefit comparisons. I would like to discuss three different subjects: The consumer perspective, why you haven't heard from consumers in your districts yet, and who is really going to be hurt by all this.

From the broad perspective, the functioning of the marketplace shows us the consumer doesn't care whether, for example, a pair of jeans is made in Paris or Belize or the United States. The consumer is going to make the purchase based on an individual interpretation of style, price, quality, and the availability of choice. And I might add the same holds true for the purchase of an automobile. And consumers have earned this flexibility in the marketplace since they pay the bill for the entire distribution system, from product design to the salesman's salary. Even the trucks built to haul goods to market, printing presses for newspapers, and tractors to harvest our food, one way or the other, are paid for by consumers somewhere.

Now, as a consumer how would you feel if you were told your Government wants you to pay more for a product but receive no more value in return? Your choice will most likely be also severely limited, or maybe not even available from that which is available today. If history is any indicator, you can also expect less innovation in the product's quality and design. If this sounds like a bad bargain for the consumer, you are right. We lose that flexibility that I think is due those paying the bills—consumers.

If consumers knew that, broadly speaking, this was indeed the generally agreed effect of the domestic content legislation on their purchasing power for automobiles and that knowledge could be coalesced into coalitions and workable themes, we might see more general public response to this legislation. As it is, we have a basic consumer economic principle at work: Earning an income generates "concentrated interest" and action but spending that income generates "diffused interest"—that is, consumers have only a vague idea of the impact—or lack of impact—of their spending.

To demonstrate this point, consider consumers spend $10 to $20 per person per year to pay for dairy price supports. That is $20,000 a year per dairy farmer's income—costing, in turn, the economy on the order of $1.5 to $2 billion. This is something like 50 percent more at wholesale for dairy products than the world price. But I doubt the dairy price issue generates many consumer letters to you.

The same kind of relationships hold up in other areas such as sugar and lower quality apparel items, yet consumers can't complain—at least not too loudly. These examples, in my judgment, demonstrate the old political adage that parochial interests always will triumph if broader interests aren't forcefully presented and debated.

However, I mentioned to you earlier you haven't heard from consumers on this issue, at least yet. We have different forces at work as a result of the impact of this legislation, than for my earlier examples of low-ticket items. Research conducted on consumers' complaints to business, and I assume that this issue will also apply to Congress as well, shows only 10 percent of dissatisfied consumers will take action to express their dissatisfaction with the low-ticket items but, for high-priced items—that is, the automobile—we can expect only 31 percent to grin and bear it while a whopping 69 percent will complain.

You have heard experts give their political appraisal of possible legal reciprocal activity exercised under the GATT, and just plain retaliation that may be taken. If these possibilities happen, they will only exacerbate more of what we already know will happen. Billions of consumer dollars will be spent for a nonvalue added product, draining the economy even further. Who is hurt by this? The employed, the unemployed, the underemployed; all of us are hurt. And because of the rippling effect to supplier and support industries, this distortion of the marketplace will hurt those who are always affected most severely, the low-income consumer. For this consumer I am talking about, for example, auto replacement parts and the affordability of reasonably priced used cars.

We are in a cycle of change from an industrial to an information age society. The transition will be painful for industries and consumers alike and will take years to accomplish. Protecting so-called "smokestack industries" is worthy of our attention but not to the extent H.R. 5133 proposes.

The important thing I believe, is the resulting effect of this legislation will not be a tradeoff between consumer price and social cost. If the bill should pass, the taxpayers' cost will not decrease; in fact, will probably increase, and consumers of automobiles, who are, of course, taxpayers, will pay again when they buy the automobile through increased price.

We are not operating here in what economists call the "veil of ignorance." We cannot ignore who this is benefiting or hurting, and at what cost. National debate resulting in different types of creative solutions and a consensus that looks to the national interest is in order. Our industries are never going to be the same again, and to ask consumers to subsidize short-term answers serves no one. Perhaps if we remember the philosophy of some of our most successful domestic industries that "the customer is always right," we can see our way clear. This is as important today in our global marketplace as it was a 100 years ago to small town general stores, to the catalog marketer, and to Henry Ford.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF MARTIN R. PETERSEN, CHAIRMAN OF THE BOARD OF TRUSTEES, COUNCIL FOR THE ADVANCEMENT OF CONSUMER POLICY

Mr. Chairman, I am Martin Petersen, Chairman of the Council for the Advancement of Consumer Policy, and I am here in that capacity though my full-time position is that of President of Knauer & Associates Inc.

The Council was founded by Virginia Knauer in 1979, to serve as a non-profit "think tank" for consumer affairs. The Council's main objectives are promoting the rights of consumers through study and analysis of consumer issues; stimulating public awareness and discussion of these issues and working for consumer priorities at the international, national, state and local levels. I should like to emphasize that our membership, comprised of individuals and corporations, supports the Council through donations. We do not claim to represent our members as we believe no organization can hold itself out as representing "the consumer" as the self-interests of individuals are too divergent. Policy at the Council is set by its Board of Trustees to contribute to and advance concern for the consumer through the stimulation of a competition of ideas.

While the Council has other achievements, our work in the international trade arena started in 1980 through a one-time grant from the Japan Automobile Manufacturers Association to undertake an impact study of the effects on consumers of a quota system for automobile imports which was completed in that year. The following year, through our general fund, we undertook a university lecture tour. This year we cosponsored with the State Department a briefing for consumer leaders on trade issues. I should note that my predecessor as chairman and myself had previously formed judgments on the consumer stake in trade through our many years of work with the consumer policy committee of OECD.

With this background, I appreciate the opportunity to testify on H.R. 5133. The history of trade deliberations show virtually no consumer involvement. Even Secretary Baldrige's paragraph about the consumer on this legislation was contained in a section entitled "Help to Auto Industry." If your constituents were informed of the probable domino effect of this legislation, they would not be in favor of it, and the cards and letters would flow. The problem is they do not have all the information and consequently you are hearing mostly from those with the most to gain or to lose.

Our work in this area indicates domestic content requirements—or any other form of quota, tariff or nontariff barrier—are not in the public interest for the general welfare of the American consumer. This country's founders voted against trade restrictions when they created the United States as the world's greatest common market. The Constitution provides no barrier can be imposed between states and we have reaped the economic benefits. Now finding ourselves in a very interdependent world, we start tinkering once more, as we did to extreme in the 1930's, with something that doesn't need fixing.

Over the last three days you have heard a great deal about the creation of jobs, displacement of others in the job market, the health of industries, frustration with Japanese trade practices and historical and projected cost-and-benefit comparisons. I would like to discuss three different subjects: the consumer perspective, why you have't heard from them—yet—and who is really going to be hurt by all this.

From the broad perspective, the functioning of the marketplace shows us the consumer doesn't care whether, for example, a pair of jeans is made in Paris or Belize or the United States. The consumer is going to make the purchase based on an individual interpretation of style, price, quality and the availability of choice—and the same holds true for auto purchases as well. And consumers have earned this flexibility in the marketplace since they pay the bill for the entire distribution system, from product design to the salesman's salary. Even the trucks built to haul goods to market, printing presses for newspapers and tractors to harvest our food, one way or the other, are paid for by consumers somewhere.

Now, as a consumer how would you feel if you were told your government wants you to pay more for a product, but receive no more value in return; your choice will most likely be also severely limited, or maybe not even available from that which is available today. If history is any indicator, you can also expect less innovation in the product's quality and design. If this sounds like a bad bargain for the consumer, you're right. We lose that flexibility that I think is due those paying the bill—consumers.

If consumers knew that, broadly speaking, this was indeed the generally agreed effect of the domestic-content legislation on their purchasing power for automobiles and that knowledge could be coalesced into coalitions and workable themes, we might see more general public response to this legislation. As it is, we have a basic consumer economic principle at work: earning an income generates "concentrated interest" and action but spending that income generates "diffused interest"—that is, consumers have only a vague idea of the impact—or lack of impact—of their spending.

To demonstrate this point, consider consumers spend $10 to $20 per person per year to pay for dairy price supports. That is $20,000 a year per dairy farmer's income—costing in turn the economy on the order of $1½ to $2 billion. This is something like 50 percent more at wholesale for dairy products than the world price. But I doubt the dairy price issue generates many consumer letters.

The same kind of relationships hold up in other areas such as sugar and lower quality apparel items, yet consumers don't complain—at least not loudly. These examples demonstrate the old political adage that parochial interests always will triumph if broader interests aren't forcefully presented and debated.

However, I mentioned earlier you haven't heard from consumers on this issue, at least yet. We have different forces at work as a result of the impact of this legislation, than for low ticket items. Research conducted on consumers' complaints to business—and I will assume to Congress as well—shows only 10 percent of dissatisfied consumers will take action to express their dissatisfaction with the low-ticket items but, for high-priced items—that is the automobile—we can expect only 31 percent to grin and bear it while a whopping 69 percent will complain. Of course, this legislation will have to pass to find out if the purported cure only generates worse headaches and calls for repeal of this legislation in 1984.

You have heard experts give their political appraisal of possible legal reciprocal activity exercised under the GATT by other countries due to our violation GATT agreements and just plain retaliation that may be taken. If these possibilities happen, they will only exacerbate more of what we already know will happen. Billions of consumer dollars will be spent for a non-value added product, draining the economy even further. Who is hurt by this—the employed, the unemployed, the underemployed—all of us are hurt. And because of the rippling effect to supplier and support industries, this distortion of the market place will hurt those who are always affected most severely, the low income consumer. For this consumer I'm talking about auto replacement parts and the affordability of reasonably priced used cars, the possible changes in transportation costs of other goods because of shifts in the transport market distribution system and the refueling of inflation. I might as well also question if our war against inflation is still important—this bill not only sends a message to our trading partners but to the consuming public that inflation might not be public enemy number one after all.

We are in a cycle of change from an industrial to an information age society. The transition will be painful for industries and consumers alike and will take years to accomplish. Protecting so-called "smokestack industries" is worthy of our attention but not to the extent H.R. 5133 proposes. It would cost us maybe 10 to 20 percent of the anticipated costs of this bill if we were to just put on the books a further unemployment subsidy—but of course, the differences are the costs could be open to scrutiny by all and further damage our national debt—both probably unacceptable to the taxpayer hat we all wear each April.

The important thing I believe, is the resulting effect of this legislation will not be a trade-off between consumer price and social cost. If the bill should pass, the taxpayers' cost will not decrease but probably increase, and consumers of automobiles, who are of course taxpayers, will pay again through increased price.

We are not operating here in what economists call the "veil of ignorance." We cannot ignore who this is benefiting or hurting—and at what cost. National debate resulting in different types of creative solutions and a concensus that look to the national interest is in order. Our industries are never going to be the same again and to ask consumers to subsidize short-term answers serves no one. Perhaps if we remember the philosophy of some of our most successful domestic industries that "the customer is always right!" we can see our way clear, this is as important today in our global marketplace as it was a hundred years ago to small town general stores, the catalog marketer and to Henry Ford.

Chairman GIBBONS. Very sound reasoning; very sound statement. Mr. Bailey?

Mr. BAILEY. Thank you very much, Mr. Chairman.

Let me just ask a series of questions. As American consumers, do you and I have an interest in the amount of taxes we pay as consumers, as individuals?

Mr. PETERSEN. I am sorry, the question is, Congressman?

Mr. BAILEY. Do we have an interest or concern as consumers, you or I, about the level of taxes we pay?

Mr. PETERSEN. Absolutely, Congressman, but I——

Mr. BAILEY. OK.

Mr. PETERSEN. I take a different perception on how we define consumer. A consumer is a person buying for personal, family, or household reasons.

Mr. BAILEY. I am asking about people who multiply these dual roles of consumers and nonconsumers. It is hard to separate that out.

Mr. PETERSEN. Yes, I agree.

Mr. BAILEY. Do you and I, most consumers in this country, have a concern about the cost of defense of this country?

Mr. PETERSEN. I am sure that the polls reflect that; yes.

Mr. BAILEY. Obviously you have a very strong concern about free enterprise, what it means?

Mr. PETERSEN. That is correct.

Mr. BAILEY. Are you familiar with how it is practiced in various countries around the world?

Mr. **Petersen**. Not that familiar; no, sir.

Mr. **Bailey**. You are not that familiar?

Mr. **Petersen**. That is correct.

Mr. **Bailey**. Are you familiar with the relative size of the American economy when compared to other free world economies? Have you ever done any work on those figures?

Mr. **Petersen**. Casually. I know that we are the No. 1 industrial nation in the world. Japan is No. 2. It trails on from there into the European Community.

Mr. **Bailey**. If there is a relationship between a consumer's interest in being a consumer, per se, as you defined it, and that individual's interest in a free world, and in free enterprise, and an assumed interest of a Japanese consumer and taxpayer and member of a free society in free trade, should there be some standard of practice in free trade that has some measure of the quality around the free world? Should there be?

Mr. **Petersen**. Yes, Mr. Bailey, I agree. For example, I think that the Japanese Government is treating their consumers pretty shoddily over the beef question; $37 a pound for beef seems absolutely ridiculous. I don't see why Japanese consumers aren't speaking up more.

Mr. **Bailey**. I agree. I even agree the Japanese Government is mistreating its consumers in terms of its resource allocations made in terms of capital-intensive industries like steel, automobiles, et cetera, as per the discussion I had with Alice Rivlin this morning. Somebody ought to speak up.

The point I am trying to make is quite obvious. With all due respect, I don't think, in terms of being able to go out and buy a good quality product, your argument perhaps would hold up. From time to time and article to article. The point I am trying to make is that there are a multitude of interests faced by American citizens. Consumer preference is part of those interests. There is an overall interest in the application of universal principles of government, individual relationships, some of which are defined in theoretical terms as free enterprise, to which we generally subscribe in the free world and that those interests are not being served by some governments and some peoples and some nations, and that they need to be a little more flexible because people are getting angry. They are starting to feel cheated. They are starting to feel prevailed upon. They are starting to feel victimized. And that to define your consumer interest more broadly would serve your ends, our ends, and the ends of free enterprise and ultimately consumers ad infinitum, hopefully.

Therefore, I suggest this bill as rather weak and inadequate, but an example of a necessary response to deal with those kinds of perceptions and attitudes affecting the decisions of policymakers overseas, is an unfortunate necessity.

I yield back the balance of my time.

Mr. **Pease**. Mr. Chairman, I have no questions.

Chairman **Gibbons**. All right. Well, thank you, sir, very much.

Mr. **Petersen**. Thank you.

Chairman **Gibbons**. This concludes our hearings for this afternoon. We will reconvene tomorrow morning at 9:30 a.m., in room 1100 of the Longworth Office Building. Witnesses at that time will be, among others, Mr. Philip Caldwell, chairman of the board of Ford Motor Co., and Mr. Philip Hutchinson, vice president of Volkswagen of America.

[Whereupon, at 3:35 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Friday, September 24, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

FRIDAY, SEPTEMBER 24, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:35 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen. This is a meeting of the Trade Subcommittee of the Ways and Means Committee. As everyone probably does not know, the House ran until about 10:30 last night, and I am sure we are going to have a little trouble getting started this morning.

Our first witness today is Philip Caldwell, chairman of the board of Ford Motor Co.

Mr. Caldwell, we appreciate your coming here. It is a very unusual treat for this committee or for Members of Congress to be in the position of discussing with you problems that affect your industry and America. We know that we have some serious problems. We look forward to your testimony about this subject and about this bill, and you may proceed as you wish, if you want to, sir.

STATEMENT OF PHILIP CALDWELL, CHAIRMAN OF THE BOARD, FORD MOTOR CO.

Mr. Caldwell. Thank you very much, Mr. Chairman. With your permission and the permission of the members of the committee, I would like to read the statement that I have prepared.

Chairman Gibbons. Certainly. We would be delighted to hear it.

Mr. Caldwell. Mr. Chairman, we have been asked for our views on automotive trade and for our perspectives on the legislation before this committee.

In preparing for this occasion, I was reminded of a couple of famous maxims. It was the late Speaker Sam Rayburn who used to tell Members of this body—and sometimes even Presidents—"If you want to get along, you have to go along." And it was Benjamin Franklin who, in signing the Declaration of Independence, asserted the very same thought in even blunter language: "We must all hang together, or assuredly, we shall all hang separately."

I have been asked to discuss something that has been advanced as a single solution to the problem of a single industry. I honestly wish it were that simple. We happen to believe that the issue is bigger than that. The essential question confronting this subcommittee, the Congress, the White House—indeed confronting the Nation—is the international competitiveness and the ultimate survival of major U.S. industries.

The need to solve this basic problem is of vital importance. The prosperity and security of America, the jobs of millions of American men and women—today and tomorrow—depend on how well the Nation meets this challenge.

We are dealing, therefore, with something that is not just an automotive problem. Other industries and their workers are facing similar issues of international competitiveness. Unless government and the private sector go along together in fashioning proper responses, none of us will get along very well.

The issue is how best to enable American companies and American workers to compete more effectively in today's highly internationalized market, especially when that competition is tilted in ways that benefit other countries more than our own and in ways that the private sector alone cannot deal with.

Highly efficient Japanese firms, for example, encouraged by a supportive Government environment, have aggressively targeted one manufacturing sector after another. The assault stretches in a long line from textiles, cameras, and televisions yesterday, to steel, motor vehicles, and machine tools today, and on to semiconductors, electronics, biotechnology, and aircraft tomorrow.

So it is not simply an auto industry problem; something seems fundamentally wrong with America's ability to compete.

It may be worth noting also that this is not just an American problem. The same pressures are being felt in Europe, where Governments already have strengthened their restrictions on Japanese imports, especially cars. Just recently the European Community has protested to the GATT in sweeping terms about the damage being caused by Japan's trade policies and the undervalued yen.

Increasingly, the American people—especially those whose jobs are at risk—are asking and expecting a meaningful response from both industry and government. Let me review briefly what is being done in and by the auto industry.

At a time when many others are not making capital investments, the auto industry is investing $80 billion to revolutionize the design, technology, and manufacturing of U.S. cars and trucks. This is the largest private sector effort ever undertaken anywhere. This commitment has been kept even though the industry is now in the fourth year of a recession.

At Ford Motor Co., these efforts reach to every product, every employee, and the very fundamentals of how we operate. We are moving in exciting new directions to give Ford product leadership in automotive electronics, aerodynamics, design, quality, and in overall efficiency.

The Ford Escort line, we are proud to say, is the best selling car in America and, with its European twin, the best selling car in the world. For 1983, here in America, we are bringing out eight new model lines at an investment of $3 billion, the greatest product effort in Ford's history. Furthermore, we are spending a greater share of our revenue for R&D than any of our major competitors, domestic or foreign.

These commitments to new products and plants for both the short and long term were made possible only because at the same time we have improved our efficiency and pared overhead costs to the bone—at savings of $3.5 billion a year compared with 1979.

Perhaps most important of all, Ford, working with the UAW, has developed a new and enthusiastic rapport between management and labor. This new spirit has already paid off in the quality of Ford cars, which has improved 48 percent in 2 years' time.

Mr. Chairman, I invite you and the members of this committee to visit any Ford plant and sense for yourselves this new spirit of mutual support and dedication between management and labor. I would like to say that is not an idle invitation. We very much would like to have you individually or collectively come and see for yourselves what we are doing.

But no matter how well we work together on the plant floor, the private sector cannot do it alone. The Federal Government, on behalf of the whole Nation, must do its share in redressing the imbalances and the inequities in trade and jobs.

Thirty months ago, Ford testimony described for this subcommittee actions that we in the domestic industry were undertaking to meet foreign competition and to preserve America's largest and most basic industry. We also suggested several areas where U.S. international economic policy could reinforce the progress gained from private initiatives: First, short-term import restraint; second, differences in tax structures among major trading partners; and third, the yen/dollar relationship.

The U.S. imbalance in auto trade and jobs is enormous. Automotive products alone accounted for $13 billion out of last year's $16 billion trade deficit with Japan. With expected recovery in U.S. auto demand, the auto deficit with Japan will reach $25 billion by the mid-1980's, even without an increase in Japanese market share.

So far this year, the market share of imported cars is at an all-time high of 28 percent. This occurred in spite of Japanese export restraint. The Japanese share of 23 percent this year is 5 points higher than anticipated when restraints were announced—because the protracted weakness of the economy in general and auto demand in particular has lasted so long. The toll on people has been very heavy—over 1 million have lost their jobs.

With less than a 2½-percent unemployment rate in Japan, compared with nearly 10 percent in the United States, Japan surely must understand the reasonableness of continuing the present level of restraint announced in 1981. Initially, there was a conviction by many on the U.S. side that it ought to be for 5 years. Our Government settled for 3. It is most important that the administration, encouraged by the Congress, show its revolve on this matter. For even though voluntary restraint has not been a perfect instrument, America's biggest industry would have been damaged even more—and thousands more jobs lost—without it.

And let me note that, despite dire forecasts, the evidence for the first year demonstrates that restraint had no significant impact on car prices, no significant limitations on buyer choice, and caused no unusual upgrading of Japanese model mix. In sum, Mr. Chairman, America's consumers have not been hurt as the critics claimed they would be.

These critics seldom mention, by the way, what replacing a U.S.-built car with an import costs the U.S. taxpayer. We estimate that the combination of lost taxes—which would otherwise be paid by U.S. manufacturers and workers—and the various costs of subsistence for unemployed workers add up to about $2,500 for each import. One might question whether it is fair for taxpayers in general to, in effect, subsidize buyers of imported cars.

We ought to remember that limiting Japanese car exports is hardly unique to America. Notwithstanding GATT rules, by one means or another virtually every major auto-producing market in the world has done so—with Germany and the Benelux countries added to the list last year. Britain has now included Japanese small trucks in its limits, and just recently Japan agreed to reduce its car exports to Canada by 12 percent.

What is also hardly unique is the fact that more and more important U.S. industries are beginning to experience the same type of trade problems as the auto industry. Just a few days ago, the Senate Foreign Relations Committee conducted hearings that spotlighted the growing Japanese threat to America's high-technology leadership in electronics, biotechnology, aerospace, and robotics.

As with the automotive industry, so with high-tech: The survival of our leadership in these critical manufacturing and technological fields is of paramount importance not only to our trade with other lands, but also to our political, economic, and military leadership in the world. In terms of international stature and U.S. national security, I question whether primacy in service industries would be an adequate tradeoff for allowing ourselves to become a second- or third-rate industrial nation. I know of no world power that has been based on a service economy.

These vital problems, we believe, cannot be resolved by dismissing them as the just deserts for the shortcomings of companies or unions, by simply pledging allegiance to the flag of free trade, by looking the other way, or by praying for miracles in the marketplace. Marketplaces have rules—if not ours, then someone else's. Trade obviously ought to be free, but the fact is it cannot be free without fairness and equity for all the players. And it will not be fair for America unless there are substantial changes in U.S. policy.

I mentioned earlier the differences in tax structures among major trading partners and the need to correct the dollar/yen relationship. These are issues of competitiveness that affect not just the auto industry but the whole U.S. economy.

In the case of taxes, it may not be widely understood that the U.S. tax structure is not nearly as well designed to facilitate international trade as the tax structures of most exporting nations. Our major trading partners minimize their income and payroll taxes—burdens on production costs—by imposing substantial sales taxes on consumption. Under GATT rules, these sales taxes may be rebated on exports and imposed on imports, whereas income and payroll taxes may not.

This amounts to a double-whammy on U.S. products. A U.S. car shipped to Japan carries a full load of U.S. taxes and Japan collects a sizable commodity tax when it arrives there. When a Japanese car is exported to the United States, Japan rebates the commodity tax—I believe it is in the range of 17 to 22 percent—and there is no offsetting tax collected in this country. The net effect is that the total tax burden on a Japanese car sold in America is hundreds of dollars less than on a U.S. car built here, or on a Japanese car sold in Japan. This certainly does not sound equitable to me.

An even more basic issue is the undervalued yen, which is in sharp contrast to the strength of the Japanese economy. Japan's record of controlling inflation, of improving productivity, its rate of savings, and its trade surplus are the envy of the world. In theory, flexible exchange rates should compensate for such differences among countries. But the yen/dollar rate has not strengthened to compensate for Japan's superior performance in inflation—let alone other Japanese advantages. In fact, the yen/dollar rate has actually weakened.

Since 1973, when flexible exchange rates were introduced, cumulative U.S. inflation has been much worse than Japan's. If the value of the yen had strengthened to compensate for this inflation advantage, the yen today would be trading in the range of 185 per dollar. Instead, it has been trading recently at about 265—an undervaluation in relation to the U.S. dollar of some 40 percent by this measure. The difference between these two rates equates to about $1,500 per car—an extraordinary trading advantage to gain simply because a currency is undervalued. This clearly is not an esoteric issue.

The reason most commonly cited for the undervalued yen is high U.S. interest rates. Since early 1981, however, the U.S. prime has dropped from 21½ percent to 13½ percent, but the yen has not strengthened—on the contrary, it has depreciated from 203 per dollar to 265.

It seems to us the exchange rate mechanism just is not functioning fairly. What a devalued currency really amounts to is a powerful subsidy on exports and an enormous penalty on imports. That does not sound like fair trade to me.

Turning to the specific proposal this committee is considering, let me offer a perspective.

First, it would be preferable for Japanese producers to come to the United States voluntarily rather than to be subpenaed by statute. Ford has long urged that auto producers who wish to sell here in high volume build their cars and trucks here—to invest their money where they earn it, to provide jobs and to contribute to U.S. tax rolls.

The concept of producing where you sell is well established in the auto industry. Ford Motor Co. has been doing it around the world for almost the 79 years of our existence. Japan itself enforced a domestic production policy for a whole generation while it was creating its own auto industry and excluded foreign carmakers altogether. Our company was invited to leave in 1937.

Second, a serious shortcoming of this local content legislation is its lack of immediate job creation. America needs more jobs now, not starting in 1985 or 1986 when the proposed legislation would really begin to take effect. A more immediate jobs impact would flow from continuing the Japanese voluntary restraint program at present levels for at least a third year—during this unprecedented period of plant and product changeover and extraordinary unemployment.

Early last year, each of the U.S. auto companies recommended to the President that these same steps be taken to alleviate imbalances with Japan in auto trade and jobs "to help abate growing protectionist pressures which threaten the fragile structure of international trade." I believe that thoughtful leaders in Japan would agree that these steps—encouraging Japanese production here and continuing voluntary restraint—meet the test of reasonableness. Various spokesmen for the Japanese Government have said these would be in Japan's best interests.

Third, I would urge the Government to take the actions necessary to correct the inequities of the undervalued yen and the disparate treatment of taxes under GATT rules, both of which work to America's serious disadvantage in the world trading community. By sending Japan a very clear message that restraints on Japanese car exports should continue, our Government will gain time that can be put to good use in attempting to resolve the basic tax and yen questions.

With these steps, it is our hope that local content legislation would be unnecessary. The proposed legislation should be viewed as an instrument of last resort to be considered when other measures to correct trade inequities and imbalances have been tried and have failed—in short, when Congress is convinced that there is no other way to solve these international competitive issues that disadvantage all U.S. industry.

In the meantime, Ford Motor Co. and its employees will continue to work together to design and build products embodying high technology and innovation, to make our quality even better, and to take other steps within our control necessary to improve our competitiveness. America is our home, it is where we want to stay, and we intend to do all we can to compete here.

To rephrase the Speaker's rule, Mr. Chairman, the American Government, business, and labor together, will have to go along a cooperative road if America is to get along in the world of international competition. Ben Franklin was pretty stark about the alternative.

Chairman GIBBONS. Thank you, Mr. Caldwell.

You were nice enough to furnish me a copy of your statement last night, and I read it last night and reread it again this morning. I have some questions about it, but there is very little in it that I disgree with.

Sometimes my colleagues in jest and sometimes in less than jest accuse me of being the last of the free traders around here. I do not really disagree with them, because I really think they are trying to paint me into a corner. That is an old political trick, and I have done the same thing, but my philosophy is that we trade to improve our position, to improve our standard of living. We trade to live, not live to trade, to put it very simply. And I am interested in opening markets because I think in that way we can improve the standard of living of all of us. And I think it is necessary that the total standard of living of this country improve. I think it is possible.

I do not want to really emulate some other country. I hear people saying the Japanese are doing this, the Europeans are doing that, and I look at both their societies and their economies and thank God I am an American. I think there is an American way and a better way, and I think our way has been a better way.

Having said that, I recognize that we do have some problems. You brought out the question of the exchange rate. While that is not something that this committee can do anything directly about, it is something that we certainly are concerned about. The staff has just reminded me that last July I asked the Treasury to look into the United States-Japanese exchange rate and report to this committee their findings. So far we have not heard from them, although we have reminded them on occasion that we do have a deep interest in that, and also we have requested the General Accounting Office some time ago to look into the United States-Japanese exchange rate problem.

I have inquired as recently as last evening to people now outside of the Government who follow the United States-Japanese exchange rate picture very closely, and the consensus was that if the Japanese are influencing the yen now, it is to try to prop it up. They too believe that the Japanese believe that the yen is too low.

Now, I notice from reading your report to your stockholders that you had a disastrous time last year with exchange rate problems. Do you have any evidence that the Japanese, other than what you cite here in your statement, are manipulating their exchange rate?

Mr. CALDWELL. May I respond to several things that you have covered here?

Chairman GIBBONS. Yes, sir.

Mr. CALDWELL. First, with respect to our financial results last year where exchange rates were a major factor, there are two things. I should say that about half of our business is outside North America.

Chairman GIBBONS. Yes, sir.

Mr. CALDWELL. And we either manufacture and sell or sell in virtually every country of the world except the Iron Curtain countries. So we have great exposure on exchange rates, and we understand that. That is part of the game when you are operating in international trade.

Our financial results were exacerbated in this regard, however, because last year we chose not to change from FASB 8, the Financial Accounting Standards Board accounting principle, to what we think is a more sensible approach that has superseded it—called No. 52. The reason that we chose not to make that adjustment last year was that there had been so much publicity about our results as we went through the year that we did not want to appear to be playing games with the books.

Chairman GIBBONS. Yes, sir.

Mr. CALDWELL. We probably will adjust. Under the rules we do have to adjust our results to the new standard in 1983. We have already made the decision to do it in 1982, which is optional, and probably by yearend we will restate our 1981. That is a historical note, and I simply make reference to it to say that the exchange rates are a major factor in providing people the results of our operation.

Chairman GIBBONS. Was this—excuse me.

Mr. CALDWELL. But I do not think the Japanese situation that I have spoken of had any bearing whatsoever on the financial results of last year. That was other countries, primarily the pound and the dollar, quite frankly. If I might just say one more word about this, because there is a lot of confusion, I think about the fact that we ran profitable businesses in Europe, and particularly in the United Kingdom which penalized us when the dollars were brought back because of the currency relationship. For another in our industry that had unsatisfactory results, when they brought the unsatisfactory financial results back to the United States it worked the other way and represented a plus. That is not the subject that I have put on the table here this morning, Mr. Chairman.

Chairman GIBBONS. Yes, sir.

Mr. CALDWELL. More specifically, do we have any knowledge of any sort of manipulation of the yen? No, we have not. And I am not really suggesting that sort of thing. I think the issue is more complicated than that, and I am not sure that I know the solution. What attracts our attention to this is not only our own observation, but my colleagues in steel, in electronics, in banking, in machinery manufacture, aircraft—everybody is concerned about the same problem.

As a matter of fact, just this morning I had notice that the chairman of the trade task force for the roundtable is trying to establish a session with three of the Secretaries in the administration so we could just talk about this problem to see if we can understand it better.

Everything we have all been taught, going back to basic economics, is that a country that has high productivity, low inflation, a favorable trade balance, should have a strong currency. Japan has all of those, and it has a very weak currency. I talked to this question just 2 months ago with Dr. Arthur Burns, and he said well, it must be the high interest rates in the United States. So we looked into that—I am not here as an expert on international finance—and the results were what I read in the statement. While the interest rates were falling from 21½ percent to 13½ percent, the yen was falling in value from 203 to 265, and today the yen-dollar relationship is almost identical to what it was in 1973, when the flexible-rate scheme came in because the fixed rates were so unsatisfactory.

Now, one additional point, if I may. Some of our colleagues in business and in banking in Japan feel exactly the same way. A conference which Mr. McCammon, who is here with me today, attended in my absence last July in Japan, included a group of top people in the Japanese field as well as a good cross-section of representation from here in the United States, including a former Secretary of the Treasury. They agreed and issued a statement to the effect that this is a problem, it is not understood, and there should be a concerted effort by both sides acting in concert with their governments to find a way to close this unnatural gap between the yen and the dollar. And at that time I believe—I have been told—I was not personally there—that a poll was taken among the Japanese as to what the value of the yen should be, and the range was something between 185 to 205, At that particular time the yen was about 250. This is from the Japanese side.

I come to you with this problem more in mystery than understanding, and my suggestion would be because of the huge impact, not just on the trading advantage for automobiles, but on electronics, steel, machinery and equipment, machine tools, everything. This is such a huge factor that it overshadows almost all the efficiency steps that we think we can take, and it really deserves serious investigation. I understand that in the Senate Foreign Relations Committee discussion here just in the last 2 weeks that a recommendation was made to that committee that the GAO look into it as you say that you have done. We would like to participate in any way. Quite frankly, Mr. Chairman, it is a search for truth. It is not a charge.

Chairman GIBBONS. A very well reasoned statement.

One of the charges that is often made in this whole area of trade is that we accept Japanese automobiles in our country and we cannot get our product accepted in their country because of the barriers. Does Ford make a deliberate effort to try to export its automotive products to Japan?

Mr. CALDWELL. Let me explain, and could I just give you a little history?

Chairman GIBBONS. Yes.

Mr. CALDWELL. If my answers are too long——

Chairman GIBBONS. Go ahead. We have the time.

Mr. CALDWELL. I believe a little background sometimes helps the understanding. Ford Motor Co. went to Japan in 1925. We are an older automobile company in Japan than Toyota and Nissan or any of the Japanese companies. As I said, we were forced to leave in 1937. Notwithstanding that, all during that period of time we had loyal dealers who tried to keep the Ford flag flying. As a matter of fact, today we have Ford dealers who are very proud that they have had our franchise for 40 or 45 years. It was startling when I discovered this the first time I went to Japan to meet with this group.

Today and in the last several years, the whole world has shipped into Japan about 40,000 vehicles. The U.S. producers—I will put it this way—producers shipping from the United States have less than half that. I think that so far this year Ford will sell maybe 2,000. The most we have been able to sell since we first were permitted to come back and have tried to come back has been about 7,000 or 8,000, not any higher than that. VW sells more than anybody else, shipping from Germany.

It is frequently said, and it obviously has to be said I think more as a figure of speech, that the reason that U.S. cars are not acceptable in Japan is because we do not even try to put the steering wheel on the side of the car they want. Well, that is not a very well-informed observation, because the truth of the matter is that the Japanese who buy foreign cars wish to have the steering wheel on the left because it is a sign of prestige. As a matter of fact, Mercedes, shipping from Germany, will ship it left or right. We ship it from Europe left or right—we will do what anybody wants—but I am told that Mercedes sells mostly left-hand-drive vehicles for the prestige reason.

That is not what I am trying to say. Basic design is not really the issue. Basic economics is the issue, and it is just as simple as that. It costs more for two reasons that I have just mentioned here today, plus the basic cost of manufacture, which by the way I think is our problem and not one that I am suggesting the committee deal with. But the sum total of that is that we are unable to lay down a car and sell it dollar for dollar. The basic cost of production from the United States is too high due to the tax situation that I have just spoken to, and that is a lot of money. We are talking about $1,500 difference on the tax, and then of course the currency situation. And the sum total of those make it so that a foreign car is a luxury item in Japan. And that means it will never be high-volume.

Now, let me say one other thing. Because of the nature of our business, we do not like not having a position in a major market like Japan. We will be announcing on the 4th of October a major effort to establish a much broader distribution network in Japan to sell under the Ford label. The franchises will be Ford franchises, and we will sell vehicles with the Ford oval. Some of them will be made in Japan, and a few of them will be imported from the United States or from our European subsidiaries. We will start out with about 60 dealers, and by 1985 we hope to have 300 or 400 dealers. We intend to have the Ford oval prominently in operation in Japan. This is not quite as good as being able to do it in a more traditional way, but we have no intention of not competing into the Japanese market. So we have to do it on terms that are sensible for that market.

Chairman GIBBONS. With the suggestion beginning with Mr. Brodhead of this committee I began an investigation of the admission practices of Japanese automobiles in this market and American automobiles in the Japanese market. I am sure it is no news to you, I believe the Japanese are discriminating against us on their admission practices.

Mr. CALDWELL. They have made it difficult, sir.

Chairman GIBBONS. Yes, they make it difficult. Here we accept manufacturer self-certification with no inspection, whereas they insist upon inspecting each individual unit, as you know. I have been working on a draft of a letter to urge them to correct that injustice. I realize the problem is not in the customs area, but within the Ministry of Transportation in Japan.

Mr. CALDWELL. That is correct.

Chairman GIBBONS. They inspect for safety features and compliance with standards to a degree that we do not subject them to, and I believe we should have reciprocity in that type of treatment. There is no reason why your certification should not be just as well accepted as Mr. Toyoda's.

I have taken a lot more time than I should have. I would like to come back and talk with you more.

Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Mr. Caldwell, I just cannot tell you of the delight with which your statement is received by me.

Mr. CALDWELL. Excuse me, sir, I did not hear all the words. You say you dislike my statement?

Mr. BAILEY. Quite the contrary.

Mr. CALDWELL. I am sorry, I did not hear.

Mr. BAILEY. I cannot tell you with how much delight——

Mr. CALDWELL. Delight, OK. Sorry.

Chairman GIBBONS. It is the sound system. We want to explain that.

Mr. BAILEY. I have been trying to stress the point consistently through these hearings that one of the reasons why this piece of legislation, which I understand you do not feel is quite the optimum response, has been proposed is because of a multitude of causes for which we have not proposed solutions, particularly governmentally. Although I did not have the opportunity to see your statement before this, you touched literally on every single issue that I have tried to stress through these hearings, and I want to compliment you for this statement. Ironically, believe it or not, the major points that you have made and stressed are consistent with the points made and stressed by Mr. Fraser when he was here.

I also would like to say to you that I have a very deep and sincere confidence and respect in American management. I sincerely believe that the failure has not been a deliberate thing, it has been a historic development, a failure on the part of the Government. And maybe it has just been a fault that we all share in this country, the policy that we have written just has not caught up with modern-day realities in many ways. I think that is best highlighted by the points that you made concerning our tax structure.

I want you to know that this is one point that I have consistently tried to pound home, and it is good to hear some reinforcement. We have to move into the modern age, either find a way to adjust our tax structure so that it will reflect modern industrial needs and growth and development and world competitiveness. I believe the primary way to make us competitive, incidentally, is through a greater use of the code, and I wish we would do that. I think if we use the tax code properly we would interfere with you in a minimal way. I see you are nodding in agreement, and that also makes me feel quite good.

Let me ask you some questions about why we have come to this point today in American economic history, why things are the way they are.

First of all, I want to compliment you for moving into or at least making that effort to go into Japan. I wish you success, and I wish I was here to help you fight some battles that I think you are going to have to face.

Mr. CALDWELL. Thank you.

Mr. BAILEY. Do you have a Ford manufacturing facility in Japan now?

Mr. CALDWELL. No, we do not. When we resurrected our facilities after World War II, which we were first able to do only about the mid-seventies, we did so by the creation of a modification center to deal with these problems that the chairman was just mentioning, because we practically had to tear down our vehicles and reassemble them to make the most minuscule types of changes in them to satisfy the requirements of the Japanese Government. And also, we had to present each vehicle individually for certification rather than to have our vehicles certified as we do here and as we permit the Japanese to do here, that is to do it from engineering vehicles and a certification that all production vehicles would meet the same standards.

One other thing. We do have a 25-percent interest in a Japanese auto company, and that is the highest proportion that we were able to buy in that company. But we do not consider that our manufacturing. We do not run the company. We are an investor in the company.

Mr. BAILEY. If I would sit down and evaluate one of the world's economies and I were to say to myself, all things being equal, which of course they are not, but facing the reality of the respective economies and the modern industrial age, I would say that as far as return on investment is concerned, Japan, ideally at least, would be very attractive. I would have a tendency to think that if I wanted to go somewhere to manufacture automobiles, all these things I hear about wage costs and benefits and all the things I hear about these hard-working productive workers and the cooperation between government and industry, I would say that Japan would be the place where I would want to build my next new factory.

I want to comment on your loyalty to the United States, and I appreciate that. But why have not more people gone in to build basic automobile manufacturing facilities in Japan if the economy and the technology and the work force and everything is so good there?

Mr. CALDWELL. Well, I am sure——

Mr. BAILEY. I know you want to go there and build cars, so I do not want to put you on the spot.

Mr. CALDWELL. I think you have made several observations that are worthy of comment. In the first place, with respect to Japan itself, you know that it has not really been a place where foreign investment has been welcome until quite recently.

Mr. BAILEY. You mean it has not been——

Mr. CALDWELL. We were not permitted to invest there or to own or buy a company or that sort of thing. There has been quite a lot of loosening of that step by step, I might say, almost a grudging step by step, over the past 10 years. But it has not been made easy nor has foreign investment been particularly welcome.

You made another observation, we might just as well talk about it, because it is the reality of the world. The production of motor cars and trucks can take place almost any place in the world, and it is quite clear that the pressures are very much to search out the most economical places in the world, because designs are rather worldwide these days.

It used to be that the Germans would not buy a car from the French and the French would not buy one from the English, and that sort of thing. Those days are gone. Everybody is buying cars from everywhere, and that is one of the realities to which I was referring here. If we are to be competitive, we have to be competitive on the international scene regardless of whom you are dealing with or where he is producing. And that is why—I think you have said it and I certainly subscribe to it—the United States really does have to become more modern in the tools that it extends to its businesses to trade in the international scene. And the tax one certainly is in that category.

Mr. **Bailey**. I do not think we are wrong about this, provided everybody around sort of plays by the same rules. So while we are open to foreign investors because we view that as a positive thing, have you as a company fought foreign investment in the United States?

Mr. **Caldwell**. Have we fought foreign investment in the United States?

Mr. **Bailey**. Yes.

Mr. **Caldwell**. No, to the contrary.

Mr. **Bailey**. You are not afraid to compete? Is Ford Motor Co. afraid to compete? You are not afraid of a manufacturer from another country coming into the United States and building a factory to compete with automobiles you produce?

Mr. **Caldwell**. No, we are not afraid, that is the whole idea. We are foreign investors in other countries. I think foreign investors have a right to come to this country, and that is what I said is the first step here. I think that those who wish to have a major place in this market ought to be encouraged to come here and should come here, and I think the Government should work with them and give them a fair break to do it.

Mr. **Bailey**. I would like to say this in conclusion—I may come back with a minor question or two. First of all, your statement very concisely outlines my view of why we are here discussing this domestic content bill today. I am compelled, however, to say that I disagree with you on its need. Obviously my reason is that I think it is a stick that at some point we have to raise. We have got to do something. We have not done the things to respond to the kinds of problems that you have so concisely outlined at all. These things have been dragging for years, and we as a government, this Congress, our administrations, Republican or Democrat, it makes no difference—we have not responded to these difficulties. And I think some message has to go out, because we need some cooperation.

Japan's role in the modern world to me is just crucial. I think there are a lot of things that we have learned from them; they have learned a lot from us. They are a strong democracy, and I think if we are going to avoid the possibility of a nuclear war, I think the only way to do it is a cooperating free world, and a strong economy plays a basic role there. I am more interested in that, and I am sure you are too, and the mere survival of Ford or the mere survival of some automobile industry anywhere, those are really the basic things that concern us as American citizens and as policymakers and you as a businessman.

That is part of our faith. Japan has to learn that she has to cooperate in that venture. I do not know how we get that message through that mentality that they have erected, although you say they are getting better at it. That is the best news I have heard before this subcommittee in a long time.

I have one more brief question, then you can comment.

Mr. **Caldwell**. Could I make a comment?

Mr. **Bailey**. Yes, could I throw in my one last question and then I would finish up, Mr. Caldwell, and I would love to hear your comment. Has the United Auto Workers Union fought you on productivity increases?

Mr. CALDWELL. I really would like to take a moment to respond to that.

Mr. BAILEY. OK.

Mr. CALDWELL. And then I would like to make an observation about your broader comments. The relationship that the Ford Motor Co., has with its employees today is the best I have ever known, and I have been with Ford now for almost 30 years.

By far, we have a greater sense of mutuality than I have ever seen. We have a respect for equity. We have a desire that is now growing in our plants for everybody to participate and to contribute, and that has been personified in the quality improvement that I mentioned.

People say, oh, well, how could you have a 48 percent improvement in quality; things must have been terrible. Well, they certainly, obviously, weren't where they should have been. That is quite true but today, because of this relationship, the quality of Ford products being produced—as shown by independent survey—is the best of any producer in the United States by quite a good margin.

On our Escort line of cars, which is one of our newest lines of cars, we are almost on a parity with the best anywhere in the world. The Ranger pickup truck, which is our little compact truck we just started building here in the last, well, hardly 6 months, has the best quality level of any vehicle built in the world, period. No asterisks, no fine print.

Mr. BAILEY. We heard some survey results yesterday. They didn't cover that product, I just want you to know.

Mr. CALDWELL. OK. I read something about it. We have a lot of reputation to overcome, and it may take us years to do it, but with the full support of our relationship that I am talking about, we are getting the results. Now, everybody knows that doing it right the first time is the most productive method of producing. We have in our plants an extensive program which we call employee involvement.

I have personally visited a number of our factories and have had an opportunity to share the experiences with the men and women on the shop floor. I couldn't be more heartened. They are telling me now of problems of which as a group they said, "This cost $1 million and that is too much."—I am talking about blue collar people now, I am not talking about supervision—We came up with a different way to do it. We saved a half a million dollars, and what we want to know from you is how are you going to get this into the other factories that do the same kind of work.

I couldn't be more delighted, Mr. Bailey, and I guess the question everybody wants to know is will it last? I believe it will. It is quite true that we have high seniority employees now because we have so many on layoff—it is more junior people that are the ones on layoff—but there is a peer pressure developing in our plants that we have never seen before. When I said to you—and I invited the chairman and each of you—come to our plants—I don't have to be there—you go in any of our plants any day, and see for yourself. To me that is the really big hope of this country, to get back to doing the things that made this country what it is, plain old ingenuity.

Everybody has something to contribute. I went through one of our plants and a man said to me, "You know, I have been in this plant for 27 years. I never put in a single suggestion, because I didn't think anybody cared, until last year, and I have made 13." And he was showing me some of those that were not only his suggestions—they were big ones, little ones, thousands of them. That is the big multiplier, thousands of good ideas.

So that is our part of the job, and I hope that I made clear that I didn't come here seeking assistance. I came because I was delighted to have an opportunity to talk seriously about a major issue.

Now, if I could comment a little bit more on the broader comments that you made. We are here, and you are holding this hearing and you are considering legislation because there is a problem, and the problem won't go away by rejecting the legislation. The problem is here out of desperation, because other solutions haven't been found.

Mr. BAILEY. That is correct.

Mr. CALDWELL. What I was trying to say is that before we take this kind of a step, could we work together? Could we really try to get at some of these other problems? If we could solve those, the pressure for this kind of legislation will diminish greatly. If we don't solve them, the pressure for this kind of legislation will increase.

Mr. BAILEY. Mr. Caldwell, the chairman of this subcommittee led a fight—and I have complimented him publicly for it before and I will compliment him again—on some of the most innovative recommendations and changes in basic industrial tax structure in this country that we have probably seen for countless years. He is a better commenter on that issue than I am.

Politics being what they are, we all know what happened to some of those ideas, but we have got to start setting partisan differences and policy difference aside, when a chance, a golden opportunity comes through to this Congress to make a major change.

We have got to jump on it. We have got to do some things with industrialization. We didn't do that. I have been through fights with leasing, you may or may not be aware of my role in that regard, basically because I saw an imperfect vehicle, but an impossible one for doing something to help you folks with cash flow. But the real idea, of course, was to do something to spur reinvestment in plant and equipment in the United States of America.

Mr. CALDWELL. Yes, on an equitable basis.

Mr. BAILEY. Yes, which is absolutely vital, and none of the vehicles are perfect, but maybe the blessing behind this whole thing of what Japan has done will be that we will reevaluate and come up with some consensus of what free enterprise means for purposes of the free world. First of all, persuade the Japanese to understand that they in a sense have got to join the philosophic views shared by ourselves and most of Europe, at least which are much more free market oriented than the so-called, I hesitate to use corporate state model as a reference, because it is a theoretic idea that is connected with fascist theory, and I want to avoid that, but a new form of State capitalism, so to speak, which has arisen worldwide, and threatens really the world's economic order and free trade among free nations. Japan has got to be deterred from following that kind of policy.

I only say in light of all this gobbledegook that I am supportive of this legislation because I don't know where else to turn. I don't know how else to teach them a lesson. I don't know how else to provide a public focus, so we disagree there. But every single other thing that you have said here today I just reinforce and encourage, and I hope you will preach across this country and around the world, and I am totally confident that when it is all said and done, this system, its openness, its policy responses, will prevail.

Yesterday the chairman and I were disagreeing on a point, and I leaned back and I said we will win, we will win. It is not because of any nationalistic attachment which we all have to what is American, but is, I think, a very profound and optimistic belief in the principles for which we are fighting and that type of thing. That philosophy is important. You know that is the issue on the world stage today.

I just want to compliment you. I think your statement was ideal. I am sorry that we disagree on the political necessity of using this vehicle to try to—this very poor vehicle incidentally, that was admitted by Mr. Fraser also—to make the point, but somebody over there somewhere has got to listen. I will put you and Ford Motor Co. and I will put those United Automobile Workers up against anybody in the world. I would be very happy to do that. I thank you for an excellent statement.

Mr. CALDWELL. Thank you very much, sir.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. Caldwell, we are very pleased to have you here this morning. We noted earlier in these hearings that the committee which passed this bill had only a couple hours of testimony, and then simply from the most aggressive proponents of the bill.

What our committee is trying to do is to accumulate information so that we can provide some broad-based attack on the problem rather than reacting, as you suggest, with an extremist response which may have side effects that do not warrant the risk of pushing it forward. You have already been an enormous help in that regard.

I have a couple of questions. When we started these hearings, Secretary Baldrige came in, and he said there were some problems with this kind of a bill that are likely to hurt us in the long run. I think he was keying off on some testimony that was later presented to us by Alice Rivlin when she was describing the CBO's evaluation of this bill, and that was that in the long run this was likely to hurt us both in our own market and in third markets, for a variety of reasons:

First, you do need competition. It would be nice if it were foreign financed and locally produced competition, but probably much of what has caused your employees and other American automobile employees to become more enthusiastic about their work and their quality and their production has been that competition.

Second, it is suggested that the bureaucratic nature of the local content bill over the long run is going to impose rules and restrictions on everybody and an extra layer of cost that we are going to come to regret.

The third factor cited is that the domestic content law, as it is written, is going to force foreign producers to go into a little higher price lines where we have been quite strong in this country traditionally and still are, and not only here but in other markets as well, and make life a little more difficult.

It will also—this is directly from Mr. Baldrige's testimony—be an incentive for the American products to give up low-cost foreign suppliers, and therefore, make it more difficult for us to export our products to third markets in the low-cost status. And he suggested that it may over the long run cause us to lose world markets.

Would you comment on that general sort of prospect with respect to the specific legislation.

Mr. CALDWELL. I am familiar with these various prognostications about what is going to happen. I would have to say in all candor I don't really share the belief that most of them will in fact happen. I think what will happen is what is in the individual self-interest. Given the fact that competitive pressures are a reality, there won't be any opportunity for runaway situations on prices or runaway situations on sourcing, or any of the other things. It will just be slow-going reality that will be out there. Every day is Monday morning.

Let me take some of those up. Obviously, any legislation injects a degree of inflexibility, and the more inflexibility we have, the less attractive a situation is, so I certainly agree with that one.

On the question of what the Japanese will do or what any other producer will do, I think at the end of the day the producer has to do what he thinks is going to be in his own best interests, and I think he will do that.

I have seen no evidence so far—and we have looked at this rather carefully—that prices have increased during this restraint period, for example. I have seen no evidence that model mix has changed. The number of small vehicles in the Japanese mix is about two-thirds. It hasn't changed, in fact. Predictions are hard to deal with because nobody knows whether his prediction is right. I mean, it is very difficult to predict, whether there is any legislation on the table or not.

With respect to the local content situation, all I can suggest to you is if that bill were passed, I have no doubt in my mind that the Japanese would wish to be a major part of this market. The number of Japanese vehicles coming into the United States today is larger than every other automotive market in the world in total, except for Japan and Germany.

The importation of cars and trucks by the Japanese in the United States is larger than the total market for Britain, the total market for France, Australia, Brazil, everywhere else in the world. It is inconceivable to me that they would decide to forego that opportunity.

Second, almost every other auto-producing country of the world has restrictions. Quite a few have local content requirements, and although the Japanese producers have done everything they could to postpone their compliance with those local content requirements, in the end they have done so. Australia, for example, is the latest one that I can cite in that regard, and Toyota, Nissan, and Mitsubishi are all there.

Mexico has a somewhat different kind of combination.

Chairman **GIBBONS**. Excuse us.

Mr. **CALDWELL**. You have a vote.

Mr. **FRENZEL**. Keep going.

Chairman **GIBBONS**. This is a rather insignificant vote. I would much rather be here talking to you than going over and vote.

Mr. **FRENZEL**. So would I, but for me it is an additional significant waste of the Federal purse and I will go vote against it. Would you complete.

Mr. **CALDWELL**. Shall I proceed?

Mr. **FRENZEL**. Yes.

Mr. **CALDWELL**. If this bill were passed, I think the Japanese would come here. I think they would build the kinds of vehicles that would fit into their overall plan the best. I think that the customer choice for the United States would not be impeded. The price situation is very hard to predict, but I really don't see any indication that there would be a great change in the price structure.

I wonder if you are aware of the fact that the average Japanese middle-size car is higher priced than its American-produced counterpart. The average size specialty car from Japan is higher priced than its American counterpart, and has been right along.

Without any regard to whether the bill should or should not be passed, I guess I have to say that I think a great many of the observations on the pitfalls and the dangers are ones that I don't share, and that has nothing to do with the merit of the bill. I am just trying to give you at least my belief with respect to how other competitors will react.

Mr. **FRENZEL**. I thank you. That is why we asked you to come here. Your statement was, I think, quite clear, indicating that the bill's deficiency is that it doesn't save any jobs right away.

Mr. **CALDWELL**. Not right now.

Mr. **FRENZEL**. If we are peddling it as a jobs bill, it is a bit of a bad promise.

Chairman **GIBBONS**. Will the gentleman yield?

Mr. **FRENZEL**. I do yield.

Chairman **GIBBONS**. Since you pointed out we can go over and save a bit of money, could we take about a 10-minute break while we go vote and try to save a little money and get right back?

Mr. **CALDWELL**. Please.

[Recess.]

Chairman **GIBBONS**. We will resume now.

Mr. **FRENZEL**. Thank you, Mr. Chairman.

Mr. Caldwell, you talked about the development of quality, quality incentives, technology transfer I guess you would call it. I guess in a world like the one we live in, everything falls pretty readily, including technology. You indicated that the technologies that you produce can be done literally anywhere.

We noted as we have traveled through Japanese plants—and I must say that I am delighted the chairman is going to accept your invitation to go somewhere and have a look at one of yours.

Mr. **CALDWELL**. Good.

Mr. **Frenzel**. We have noticed that they are fairly high in robotics, mostly with American equipment or equipment manufactured in Japan under license from American companies. But what impressed us more over there was the spirit of the employees. So what impresses me perhaps most about your testimony is your statement of the spirit of your employees, how that is beginning to change.

Do you want to embellish the business of technology transfer or comparability of technology between various companies, production units in various countries, and would this bill have any effect on that particularly?

Mr. **Caldwell**. Yes, I will be glad to make a few observations. In your earlier comment you were quoting one of the prior witnesses to say that maybe the domestic companies, if this bill were law, would be impeded in their capability to search out lower cost sources or to take advantage of technology wherever it occurs throughout the world. Certainly theoretically that is true. I think I should tell you where we stand.

I don't profess to be expert on how you would administer this bill, but our people have looked at it. Based upon what they think the definitions mean, if applied to our company today, we would have 98 percent local content. We have looked at it slightly differently, and we think we have about 95 percent local content in the way we would normally talk about it.

Over a period of time, obviously, we ought to go wherever it is best to go. I certainly agree with you. Every time you insert inflexibility into a system, by the passage of a law, you complicate life that much. Certainly for the foreseeable future, unless there is no solution to these other issues that I have talked about, I don't think that there would be a great deal of impact on the principal domestic producers.

If there is no solution to some of these problems, then the pressure will be great to source vehicles—whole lines of vehicles—in various places in the world, and that could dramatically change the mix in the sourcing of vehicles.

I don't tend to take a black or white view of that. I think we are dealing with more gradualism.

As far as the robotics are concerned, robotics has become one of the buzz words of our industry. I think it is helpful to note that our own company had one of the first robot installations in 1961, and, as a matter of fact as recently as 1979, Ford Motor Co. had more robots in operation in its plants than anybody else.

We in the United States, and maybe in Europe—I am not sure about Europe but certainly in the United States—use a little different definition of what a robot is than the Japanese do. The key ingredient in our definition is "reprogramable."

I think the key part of the Japanese definition is a device which simulates a hand. You pick up and you put down. We don't call that a robot. There are hundreds, almost thousands of cases like that, so I think we shouldn't be mystified by statistics in this regard, unless you really want to go into it in a rather deep way.

The development that I foresee on the technological front is huge, and the key part is electronics, because it is not the mechanical part of a robot that makes the difference. It is the brain part of the robot that makes the difference, and the brain is the computer. The computer is making a big difference and will make an even bigger difference in the design of the motor car itself. Let me make that a little clearer—in the motor car itself, in the design of the motor car itself, and in the production of the motor car.

In my opinion we are really just on the edge of that revolution, and I think it is very, very important that this country continue to be on the leading edge of that revolution, and that requires that we have very close cooperation between our industry and the electronics industry and particularly the computer aspects of it.

There is a third partner in this activity that I think is awfully important, and that is the research institutions, the colleges, and universities of this land. There, I am very glad to say, is an awareness of this, and I think that is the way we are going to have to compete.

We hear so much about the Japanese consensus method of getting along, and it is useful, and it is good. We also hear about the close cooperation between government and business, and that is a fact, and it is important.

We have a different heritage with respect to so many of these things, but if we are to get the full advantage out of the technology that is very much on the table right now, we really need to have a very close working relationship with the private sector, the government sector and the education sector.

There is a group in this country, a small group, that has been in existence for about 2 or 3 years now called the Business Higher Education Forum. Its members—it is a very loose kind of thing—are maybe 25 of the principal university heads, and about the same number from a cross section of industries chief executives.

This group has been asked by the White House to submit a report on innovation and what it takes for us in this country to take full advantage of innovation. Dr. William Baker, who was formerly head of Bell Labs, is the person who is probably overseeing the actual writing of this report. I couldn't be more delighted, because all of his background is commercial—he has been in an organization that developed science and the application of science for commercial reasons and purposes.

I hope that the auto industry will be an important illustration of what I am talking about, and I suspect that some of the recommendations that will be made in that report will call for changes which probably will be within the jurisdiction of this committee, so I am excited about this subject, Mr. Frenzel.

Mr. **Frenzel**. Thank you. On this committee one of the reasons for these hearings is that we were trying to probe for alternatives, and you are really the first witness that has provided some alternatives and suggested that they ought to be explored first, such as the one you just described, the cooperation which I hope would also include labor as well.

Mr. **Caldwell**. I didn't mean to leave them out of it. I am sorry. That was an unintended oversight.

Coming back to Mr. Bailey's question, and I probably didn't answer it as directly as I should, we have not had any impediment to the application of technology from our union.

Mr. **Frenzel**. That confirms the testimony we had from UAW the day before yesterday. Other suggestions that you gave us in addition to trying a little cooperation instead of conflict was to make our export incentives or import disincentives equal with those around the world, and you talked about various taxes of countries which are not so heavily reliant on the income tax, which can be remitted at the border, and that is a good thing.

On this point I might say that our woes here are self-inflicted.

Mr. **Caldwell**. True.

Mr. **Frenzel**. We can have such tax incentives if the country wants them. So far our country depended on an income tax. It is unwilling to go to excise or VAT's. When we do something like a VAT, our tax reformers tell us it is some awful transgression against tax purity.

Right now some members of this committee are working on a territorial tax system, which would mean that our exporters would only pay taxes in the country in which they are doing business. It is very difficult to secure industry cooperation on this matter, because everybody is nervous and they know this now and they don't want to get out of that and perhaps they don't realize that maybe they are going to have to lose that at some time.

How do we promote an export incentive attitude in this country? Every President that has had the pleasure of serving with me here has had a strong export enhancement statement of policy, and none of them have ever been willing to put a nickel on the table to give Americans some incentive to go abroad.

Mr. **Caldwell**. I wish I knew the answer to that question. I guess I have to say it is a big education proposition. Our country has been blessed by having within its own borders so many resources over the years, and we have not, except for some notable raw materials, really been dependent upon others. I remember the first time I ever visited Helmut Schmidt 5 or 6 years ago, and the only reason I bring him up is because he spoke precisely to this problem. He said, "You and your country have never had to depend on exports to live, and therefore you don't know how to deal in international trade. We in our country absolutely have to have exports to live, and therefore we think about it every day."

Well, I thought of it so many times, and it is so true, but we are losing our relative independence with respect to that. I don't necessarily think that aspect is bad. It is just a fact. I do think that more and more industries and more and more work forces and more and more people in this country are becoming aware of the fact that we are in an international competitive situation, and not a national one. But how do we get beyond what I guess you would say is the good talk about potential good works.

I don't know, except I could pledge to you I do think there is a greater awareness in the business community than I have ever seen, and I do think that some business organizations—and I would be glad to talk about it further if you would like sometime—would be pretty receptive right now, and maybe I could make one other suggestion which might be considered heresy to some degree.

In a way, I think the existence of this bill before us has attracted so much attention throughout the total scope of industry that if you chose, you might be able to use this in the way that the proverbial Georgian has in the past used two-by-fours, if you understand what I am trying to say.

Mr. **Frenzel**. I do. I think you are right. Much as I would quarrel with my friend Don Bailey about the risks of the bill, there isn't any question but what the presence of the bill has caused all of America to focus more directly on the problem to look for other solutions, if this one may not happen to fit everybody's exact bill of specifications.

Finally, I want to talk about the yen-dollar. You mentioned it several times in your presentation. That has been a matter of real concern to us, particularly in our relationship with the Europeans. We have listened to them lecture so violently on the fact that the Japanese yen is artifically low, but they, like us, have not been able to find a real shred of evidence as to why it is.

I have sort of come to the conclusion, based largely on ignorance, that if we can't find somebody messing around in the game, it may have to do with the down quarters in the Japanese economy, the consistent deficits that they have run the last 4 years, which are larger than ours, and the fact that they are a conversion economy paying for most of their raw materials and all of their energy in terms of dollars anyway, so that you may not be getting the full differential that you pointed to in that 1,500 bucks, because what they are selling us has got a lot of dollars in it already.

I would like you to comment on that, but first I want to say that the chairman and all the members of the committee want to go into this more and more carefully, because if you are going to have a free trade, relatively free trade situation in the world, which most of us at this table would suggest is a pretty good thing, you have to have a currency exchange program that fluctuates and is the balance when you have strange conditions in all countries.

You have to have a relatively free foreign investment program as a part, as a corollary to a relatively free trade situation, and you have to have some method of balancing the taxes, as you have pointed out.

When we we wrote the GATT we didn't think of any of those things. All we were doing is trading.

Mr. **Caldwell**. That is correct.

Mr. **Frenzel**. We have got to integrate all of those problems not into the GATT, but into the whole international framework, and any help you can give us on that currency problem would be very, very helpful.

Mr. **Caldwell**. I think you make a statement there with respect to the principles which I certainly agree with. The concept of free trade has always had as a corollary—and I think it has generally been thought that it just went along—the flexibility of the currencies to represent the competitive, the relative competitiveness of nations. When that is interrupted, you begin to say, "Well, it isn't really free trade."

I don't think anybody really anticipated, when the concepts of free trade were developed, that you would have the capability of having literally billions of dollars in hot money that could be transferred by the flick of one punch on the computer moving all around the world. Nobody ever thought of things like that. That is what technology has done. Maybe we have had technology in the equipment, we haven't had the technology in our trading principles.

Mr. FRENZEL. You are right. We ought to slow down services a little.

Mr. CALDWELL. I don't know about that.

Mr. FRENZEL. And get some of the other things.

Mr. CALDWELL. Let's catch up on the other side. The only suggestion I could make to you—the specific one that I would say—I have had enough individual conversation with people who are seriously trying to get at this problem, in a whole variety of industries, to know that there is a broad base of interest and a willingness to work together.

To get a little bit more organized about it, the International Trade Task Force of the Business Roundtable—Lee Morgan, who is chairman of Caterpillar, is the chairman of that group—has this high on the list. He is chairman of the committee. I happen to be a member of the committee.

I would like to report to him, if you would think well of this, the broad interest of this committee and possibly we ought to talk about it a little bit, and see what ideas might come out of it.

Mr. FRENZEL. I think that would be a good idea.

Mr. CALDWELL. If you would like me to pursue that, I certainly would be glad to.

Mr. FRENZEL. I would appreciate it.

Mr. Chairman, I have become a Don Bailey; I am afraid I am going to have to yield the rest of my time. I have certainly enjoyed the discussion and I thank you for your thoughtful testimony.

Mr. CALDWELL. Thank you, sir.

Chairman GIBBONS. Mr. Caldwell, we will be right back. We have another vote on, and then we will go right to Mr. Pease. You have three plants in his district.

Mr. CALDWELL. Right. We are a very big citizen of Ohio.

[Recess.]

Mr. FRENZEL. Using authority I don't have, I will reconvene the meeting and recognize the distinguished gentleman from Ohio.

Mr. PEASE. Thank you very much.

I think we have just had an historical development here. When the chairman gets back and finds out he has been usurped, we will have a revolution indeed.

Mr. Caldwell, I would like to join my other colleagues in congratulating you on what I consider to be an absolutely splendid statement. Your conclusion on domestic content is not the same as mine, but otherwise certainly your analysis of the situation is better than any I have seen from any witness, and I really commend you for it.

I think as Mr. Frenzel said before me, you are really the first person who has offered some concrete alternatives that we ought to pursue. You know I think that there are three Ford Motor Co. plants in my district, and probably 10,000 people work at the Brook Park plant and live in my district and are also constituents of mine.

So I have a great interest in the Ford Motor Co., and I must say I have been encouraged by your appearance here this morning about the future of Ford.

When that new Thunderbird comes out and is produced we will expect great things out of Ford sales.

I would like to talk about just a couple of things with you. One is the exchange rates. I think that discussion has been pretty well completed, but there is an area that we really ought to pursue, Mr. Chairman, in our subcommittee. I, when I go back to my district, talk to the 50,000 people in my district who are unemployed. I would like to try to give them rationale reasons why things aren't so good, and when they say the Japanese have those big tariffs on our cars, I have to point out to them they really don't have the tariffs. I try to point out to them the problem of low-volume rather than high-volume sales and the change in the Japanese market and the tax they have based on weight and power and so on.

But I would like to be able to give them a rational answer on exchange rates as well. I was hoping this morning that when you raised this question you would be able to point the finger at who or what is causing this problem, but I gather from your responses to other questions that you don't have any guilty party waiting to be identified, that you are as much mystified as anybody else by what appears to be a contradiction in what one would normally expect.

Is that true?

Mr. CALDWELL. That certainly is correct. First, let me thank you for your compliments about our company and what we are trying to do.

One place that I would like experts to look at on the exchange issue is the low interest rate in Japan itself, and whether or not there is some relationship between the fact that Japan is pursuing a different monetary-fiscal policy, almost the reverse of the one that we are undertaking to pursue.

In 1978, the yen did reach, I think, at a low point—or the high point I should say—a value about 180 yen to a dollar. That is the only time since 1973 when the relationship between the yen and the dollar seemed to be in line based on a parity purchasing power type of index.

But of course, we started pursuing a different monetary policy. Whereas historically we have tended to keep an eye on the interest rate and let the money supply go free, now we are just the opposite. And I am not saying that to be critical of our policies, but I do think that there must be some relationship between the fact that their prime rate is only about 6.5 percent and our prime rate, of course, got to as high as 21.5 and is still 13.5. There is no question that their savings rate is higher than ours—there would appear to be some excess capital—capital outflows tend to depreciate a currency.

Those facts are pretty well known to people whose judgments in these areas I accept and whose experience is considerable, and their response to that has been, in the conversations that I have had, that that is all true.

But what we really need to do is to have some leadership on both sides directed toward achieving a result rather than to explain a result that has already happened. I think we need to make some history here rather than read some history, if I can use an analogy.

Those are some places that I would like to see people look, but I don't know that I am giving you very satisfactory answers because I don't have satisfactory answers.

Mr. **Pease**. You mention in your testimony the fact that the U.S. prime has dropped but yet the yen has not depreciated in value. Despite the fact that the prime rate has dropped, the Federal deficit, actual and projected over the next several years, has increased dramatically since 1980. Do you think that might be a possible answer to the anomaly we are talking about?

Mr. **Caldwell**. Well, I don't think so. As I understand it, the Japanese deficit is greater than ours. I am not really sure how all these things fit together. I listened to the explanations, but I still keep coming back to the fundamentals, that the productivity is better, the inflation rate is better—not just marginally, the inflation rate has been half.

Our inflation rate is down, but the Japanese inflation rate is somewhere between 2 and 3 percent. Their's is down too. Their trade balance is a factor, certainly with us, and I guess there is another point here. I think the yen is not out of balance so much with other currencies as it is with ours, and that makes me wonder why.

Mr. **Pease**. Mr. Caldwell, on page 4 of your statement you mentioned that with the expected recovery in U.S. auto demand the auto deficit will reach $25 billion by the mid-1980's, even without an increase in the Japanese market share. Does that assume a lapse in the present voluntary restraint agreement on the part of the Japanese?

Mr. **Caldwell**. Well, it didn't really deal with that. It just assumed that we would have a total industry of 15.5 million vehicles compared to 10.8 million in 1981, and using the same 22 or 23 percent penetration.

So it really wasn't dealing with that—those were the two factors: The size of the industry and the amount of the penetration, however it occurred.

They are both forecasts. One is a forecast of what the industry might be and the other is just holding the existing penetration rate, and that is what gives you the $25 billion.

Mr. **Pease**. If we were able to maintain voluntary restraints of 1.6 million that would reduce the penetration rate and reduce the deficit?

Mr. **Caldwell**. Correct. The 1.6 million was arrived at when the judgment of the people working on the problem was that the industry would be 9.8 million, and therefore that gave an 18 percent penetration result. Of course, it turned out that the industry was 8.5 million and not 9.8.

For the second year it was estimated the industry would be I think 11.8 million, and of course it looks like the second year is going to be more like 8 million.

When you deal with an absolute amount against a shrinking pie, then the size of the slice gets bigger. And I guess there is one other thing I might say while we are on that subject.

The reason that I suggested that the policy of reasonableness would apply here is I have no reason to believe that the Japanese thought that there were going to be 4 long years, consecutive years, of very depressed total markets. And I would think that although people were thinking that this problem would be behind us and the economy would be back and that demand factors would be higher and that there would be more capital and more employment, none of those things has happened. So reasonableness would suggest that maybe as our trade representatives discuss this subject with the Japanese that they should discuss it in the light of not what people hoped would happen but what really did happen and what the current circumstances are.

And I would think that the Japanese would be receptive to that, because they do really understand reasonableness when we assert a position with some conviction.

Mr. **Pease**. Do you happen to know offhand when a decision must be made about whether the Japanese will extend for a third year their voluntary restraint?

Mr. **Caldwell**. Sometime between now and March of next year, because the year ends with March of 1983. I think now is the time, and perhaps conversations are going on. I am not really informed on that.

Mr. **Pease**. I think that is an avenue that some of us in Congress can pursue to encourage the administration to seek such an extension.

Mr. **Caldwell**. Well, that certainly is the only thing that will have anything to do with employment at this particular moment, as we were talking about earlier.

Mr. **Pease**. I am indebted to you, and I think the rest of the committee is, too, for your suggestions about differentials in taxation and our policies and Japanese policies getting different treatment under GATT rules.

As I mentioned to you earlier privately, it is probably not very feasible for us to change our tax structure with an income tax to a basically sales tax orientation, but we might, if members of this subcommittee pursue the possibility of changing the GATT rules so that there is more equitable treatment between those two systems of taxation.

I think that is a very good suggestion. What about out sourcing? You mentioned that earlier in connection with domestic content legislation. Is my memory right, have you reached agreement with the UAW regarding a policy on out sourcing?

Mr. **Caldwell**. What we agreed with UAW was that we would not close down plants during a certain period of time. I think the more important thing than a written contract is that we have tried to be communicative on a timely basis with an explanation of why we thought we had to do what we thought we had to do. We have undertaken to share that kind of information with the union leadership, including at the local level. We have also had several cases when we simply said this is the international competitive situation, what can we do with our own plants working together? Can we meet it? And if we can, then that takes care of the issue.

And we have had some success at that. I hope we will have more. I guess that is what competition is all about, and there has been a willingness on the part of the work force and the union leadership to discuss these matters in the spirit of competition.

Mr. **Pease**. Mr. Caldwell, one of the most distressing experiences for me over the past couple of years has been to talk with consumers in my heavily auto-oriented district and have them inform me that they are buying Datsuns and Toyotas and so on because they think they are better cars. I grew up in a generation when one didn't see Japanese manufacturing to be equal to American, much less superior. We had with us yesterday a private consultant who gave us the results of his study of consumer perceptions and attitude, and in terms of consumer perceptions of defects on delivery of new cars and experience with correction of defects by dealers, the American cars were at the bottom of the list and the Japanese and German cars were really at the top of the list.

Doug Fraser came in here on Wednesday and said that he thought things were really turning around in terms of quality in the auto industry and that he felt that our cars were superior in terms of long-term durability and durability of the drive train apparatus, rust resistance, and safety as well.

I asked the consultant if he had done a study of those things and he said no, it was really limited to new car buyers and their perceptions within a year or 15 months after purchasing the car. I would like to think that maybe we could do some catching up on defects on delivery problems and I would like to think that our cars are better in terms of the items that Mr. Fraser mentioned, but I must say I am a reader of Consumer Reports magazine, and their frequency of repair charts do not console me very much.

I looked back 3 to 5 years before recent changes. They have a system where they have black dots and red dots. If you have red dots that is good, if you have a bunch of black dots, that is bad. The frequency of repair complaints to consumer reports from their subscribers certainly favored foreign cars 3, 4, and 5 years of age.

Can you give me any reassurance in your own view of where we stand now and where we are going in terms of these kinds of quality considerations which could certainly make a difference in auto sales?

Mr. **Caldwell.** Yes, I think I can. Obviously I have to talk about my own company, because that is the part of the business that I have more specific information about. There is no question but what we had a problem, and we just had to deal with the problem, and I will give you the data that we have.

Our own measures, and we have several, have shown that in 2 years' time our car improvements in quality have been 48 percent by measures that we keep. We also went to our customers, and we get the same score back. That made us feel good on two or three counts. In the first place, we had the kind of an in-house measure that was in tune with the customer's experience, which is what you always want to have.

We went beyond that and commissioned an independent survey which was taken at the 6-month experience level; in other words, asking owners of not only our cars but our competitors' cars, domestic and foreign, 6 months out about what we call things gone wrong. Now this is just the way the customer sees it. We didn't tell him what that meant, he just told us.

But that was true with everything, so presumably if we didn't have precision in one case, we didn't have precision in any case. And the results there showed that our cars are the best cars built in this country compared to each of our other competitors—12 percent better in the case of one competitor and 24 percent better in the case of a second competitor—and equal to all the Europeans that we had in the survey. With respect to some of the Japanese cars, we approach parity, and with others we are still lagging.

That is where we are. That is current production. The perception that is out there in the marketplace, of course, is an assimilation of everybody's experience over whatever period of time, and not only his experience, but what his neighbors thought and what everybody said, and I guess my plea at this particular point is I would be very happy if we could all start talking about more nearly current events. First that would be accurate, and secondly we would be helping ourselves.

Right now we seem to have a drum fire of everybody wishing to tell the greatest horror story that he can find, and I think we have indulged ourselves enough in that, if you will permit me to say it. I think the time is now to talk about the present and the future and spend a lot less time about the past. We could spend hours and days talking about who put the dirt in the carburetor, but we all put the dirt in the carburetor. Why don't we agree on that and go on.

With respect to future prospects, I think they are very good. They are very good at least in our case because of the attitude of the men and women doing their jobs. I was in our plant in Chicago a week ago Monday when we started to build our new LTD's and Marquis—and by the way, that is a middle-sized car. I drove in one today coming up here, and I was told by the driver that when they drove down from Detroit with that car to deliver it to the Washington office, they got 40 miles to the gallon on the highway, 26 miles per gallon in the city. Is that quality? I think it is.

I think the American people think of that as being quality. Safety—well, I think we have had some data that haven't been entirely fair on the safety thing, and I am not going to quote that information because I don't think it is fair, I don't think it is fair to the foreigners.

But I do think that our U.S. cars are safer in part because they are larger and there is more crush distance and that sort of thing. And durability, I think we do have a plus on durability. I am more interested in the durablity that we are going to have in the cars we are building now than the durablity we had, because we have improved our durablity a great deal and we are continuing to do so.

I don't see any reason for us to surrender a leadership position on items of technology and innovation and fuel economy and quality.

The problems that I see that we really have that are tough to deal with are basically cost problems. Some of the cost problems that we have to deal with have to do with compensation and they have to do with productivity, and some of them have to do with taxes and yen-dollar type relationships.

We must deal with the former. I think that you have to assume some responsibility for the latter. I see a lot of encouragement for the future, and I think you should say to your constituents, it took some time for us to get into this thing. I hate to have to use that cliche, but it happens to be true. I think the American producers are well on their way to going somewhere, and my hope would be that we could carry that message throughout this land, and I think it is timely to do it now.

We need to get this industry going again, but we need to get the economy going again, and I am going to make one stump speech here for 30-seconds longer because I happen to believe it. We are in the doldrums in the economy and all the history since World War II says that you have to have housing and car sales to lead you out of the doldrums. I think it is time for us to get going, and we have got a piece of that.

I don't know how to do it all, but I will tell you, we are determined to do our part.

Mr. PEASE. Thank you. That was an excellent and very, very encouraging statement.

My last question I think follows from one of the things you just said. The Ambassador for Trade, Mr. Brock, testified before us earlier this week and referred to the Presidential program which was announced last year for assisting the domestic auto industry. Mr. Brock mentioned that one aspect of that was reducing excessive regulatory burdens and went on to say that the cornerstone of the President's initiative for the auto industry was and remains his economic recovery program.

Do you feel encouraged or sanguine about the economic recovery program working and providing the way out for the auto industry?

Mr. CALDWELL. There certainly is a big identification between the general economy and the auto industry, and I will try not to make any statements like a predecessor did 20 years ago down here which got him into a lot of trouble. But the principle was sound even if the selection of words was unfortunate.

Chairman GIBBONS. That was a different company, wasn't it?

Mr. CALDWELL. The most important single thing I think that has come out of our economic achievements has been the reduction in the inflation rate, and that has been superb. We ought not to take that lightly, because that rain fell on everybody, and everybody needed to have that rain let up.

On the regulatory side, I think the part that we welcome has been the elimination of what I would call an adversarial relationship, which was very debilitating, very. There has been a greater respect on both sides of the table for trying to deal with the issues before us in a cooperative way rather than an adversarial way, and that was a real breath of fresh air. I hope we can continue that indefinitely.

Some interpret that as sweeping the regulatory problem under the rug. I do not, because we are all citizens, you know, whether we are producers of automobiles or legislators. We are all citizens, and we all have a stake in this country.

On the monetary side, obviously I guess the piper had to be paid, and I am afraid we were one of the industries that has had to pay, and our workers have had to pay, and it has been bloody tough. I don't know whether there was another way, but I haven't heard anybody say or describe any way that was painless, and I am afraid we had to bear a lot of the pain.

We really would like to stop being pained as quickly as possible, however, because for 4 years—we had a running start in our industry. We are in our fourth year of recession. I don't think we have gotten our fiscal affairs under control yet, as you have suggested here. I think we need to work together all that we can on that.

We have been living beyond our means, and we can't do that for very long, so I guess you are saying: has this been helpful to the industry or hasn't it. We haven't gotten much largesse yet, but I do think we are better poised than we have been for some time. There is a pent-up demand, in my opinion, out there, and that pent-up demand will be served. I think we are going to have some good years ahead for our industry. I don't think they are too far off, and I think we are better prepared to take advantage of them.

We do have some burdens on our back, some of which we have discussed here this morning that I think we should address as quickly as possible, however.

Mr. PEASE. Thank you very much, Mr. Caldwell.

Chairman GIBBONS. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you very much, Mr. Chairman, and I just wanted, now that your long morning is drawing to a close, before we say goodby, to say hello and welcome.

Mr. CALDWELL. Thank you.

Mr. VANDER JAGT. We are very glad, Mr. Caldwell, to have you before the committee. I apologize that I did not hear your statement. I did have an opportunity to read it, and I thought the statement as well as your answers were very helpful, were very constructive, showed a great deal of obvious knowledge, and creative and innovative ideas too. As a Congressman from Michigan, I was very, very happy that you were here this morning.

Mr. CALDWELL. Thank you.

Mr. VANDER JAGT. I particularly enjoyed what you labeled your 32d stump speech, when you said new housing starts and auto sales can lead this country out of the slump that it is in. You didn't want to go quite that far because one of your predecessors got in a little trouble with it. I will say what perhaps you were thinking. What is good for automobile sales is good for America, and that is what our economy needs.

The gentleman from Ohio cited the consumer analyst that testified before us yesterday, and he cited that report very accurately about the desire of people for dependability and not having repair problems as soon as they buy a car. The one thing that I think you might be proud of, that though the gentleman from Ohio was correct, there seems to be greater satisfaction by customers with foreign cars than with domestically made ones, the company that showed the most dramatic improvement of all of the cars was the Ford Motor Co., so that should warm your heart.

Mr. CALDWELL. That sounds good. That is a good start. I will be glad when more people recognize it.

Mr. VANDER JAGT. I have just two very—well, one quick question and one that you may want to elaborate on. If this bill were to pass, can you estimate when the jobs would be created? When would employees go to work as a result of action taken by this bill?

Mr. CALDWELL. I think primarily 1985–86 and beyond.

Mr. VANDER JAGT. So there would not be any great addition of jobs as a result of this bill in the remainder of 1982 or 1983 or 1984?

Mr. **Caldwell**. I think it would not be great because of the lead time to get involved, to invest. You have to go through a planning stage and a get-ready stage before you can produce, and I think that would take about that long.

Mr. **Vander Jagt**. So we are really talking about 1985 before any significant impact as far as jobs are concerned?

Mr. **Caldwell**. 1985–86, I would think.

Mr. **Vander Jagt**. Thank you.

My last question is this. I was impressed with some of the new insights, the creativity that you brought to bear on this, and as the gentleman from Minnesota pointed out so correctly, that is one of the purposes of these hearings, to look at the whole picture and what might be done.

I was wondering if you would have any reaction. When this bill was in the Commerce Committee, there was an amendment offered to make these trade restrictions discretionary rather than mandatory, and that amendment failed by only one vote. It failed by a vote of 20 to 21.

You mentioned the need for negotiating fairer trade with our trading partners. You cited the undervaluation of the yen and some of the tax matters, and there may be trade barriers in other areas.

What about a bill that would say that if we did not receive cooperation from our trading partners in working toward fairer trade, then and only then the President would be able to apply these restrictions on trade; would that not strengthen his negotiating hand and possibly lead us much more rapidly to a trading situation which approaches greater fairness?

Mr. **Caldwell**. I think the realities of the situation are that this bill would have the greatest impact on Japanese producers. I think it would have virtually no impact on producers elsewhere in the world.

If that be the case, and I believe it is the case, then I think the direct approach to go from A to B would be to carry out the negotiations with the Japanese Government—it has to be government to government, of course—to get the job done, and not try to be oblique about it. Why not just take it head on?

What I was suggesting earlier, and I would like to come back to this, is that the problems we have been talking about are here. Whether the bill is passed or is not passed, these problems have to be dealt with at the end of the day. The existence of this bill, and its likelihood of passage, are probably the most significant, I hate to use the word weapon but I guess you could say that, that this Government will have, and you in Congress have this in your hands to use.

So if the name of the game is to solve the problem, not to pass a bill or to set up or create a new approach with a lot of restrictions, why not use the bill as a significant part of the negotiating process, and do it directly, and determine whether or not you can solve the problems. That has been my point.

If we can solve the problems, you don't need the bill. If you can't solve the problems, and there is no other way, then at some point you and Congress may conclude that you have no choice.

Some are saying, "well, I have already reached that conclusion, and I don't think there is any choice—it is fine to have the conversation, but we have been having a conversation for a lot of years now and nothing has happened". Therefore I conclude, some are saying, we have to pass the bill because there is no choice. Others are saying, and I guess what I am saying is, let's try one more time, because I do think the opportunity for successful negotiation is better today than at almost any time I know, if we will all pull together.

The thing that has been missing has been lack of common purpose, if you will permit me to say it, on our side. There is very common purpose on the Japanese side, and if we could meet with common purpose on both sides, I think we would get a lot done. I really believe that.

But if we meet without common purpose on our side, with naiveté, or maybe just plain lack of experience, against the pros, if we have unequals at the negotiating table, we are not likely to be successful. This happens to be a time, and I do think you have a resource here with this bill to get a lot done that really does need to be done for the good of the country.

Mr. VANDER JAGT. Thank you for a very excellent answer and thank you for being here this morning. We do appreciate it.

Chairman GIBBONS. Mr. Caldwell, I know you are getting tired. I will try to be brief. Our overall trade deficit with Canada is about the same as our overall trade deficit with Japan, although we don't recognize that fact very often, and don't seem to get as mad at the Canadians as we do with the Japanese. How would the enactment of this legislation affect the overall operation of the United States-Canadian auto agreement, and how would it affect Ford in Canada?

Mr. CALDWELL. Mr. Chairman, I am not completely sure that what I am about to say is accurate, and the reason is that people keep asking this question. The mere fact that they keep asking it—and some have said it will make some difference—makes me think that maybe we are not seeing everything in it. But it is our belief that it has no impact.

We would still have to comply with the provisions of the auto pact, and we would have to comply with the provisions of this bill. I may be wrong in that. Obviously we have to comply with both, unless you chose to terminate the auto pact arrangement, but I haven't heard anyone suggest that yet.

Chairman GIBBONS. The reason I asked you that question is because I don't know how it will affect you either, honestly.

Mr. CALDWELL. I don't think it affects us. That is what our analysis seems to show.

Chairman GIBBONS. This being a later piece of legislation, I think it would probably override the auto pact. If the auto pact were overridden, what would happen to you in Canada?

Mr. CALDWELL. I think Canada would be the loser in this.

Chairman GIBBONS. Yes, there is no doubt in my mind.

Mr. CALDWELL. Because Canada now is getting cars from the United States, and with the value of their Canadian dollar being what it is, they have the best buy in the North American Continent today, because of the auto pact. If that ceased over a period of time, then, of course, there is a lot of jockeying around that would go on.

It would take a while to do it, because we can't move these factories around, but I would think at the end of the day the Canadians would be the losers, not the United States.

Chairman GIBBONS. I don't think this bill is going to become law this year. It may pass the House of Representatives, but I don't think it will become law, but certainly this is one area that we need to look at very closely.

Mr. CALDWELL. I agree with that.

Chairman GIBBONS. Because in my opinion we have enough problems with Canada already.

Chairman GIBBONS. And they are getting worse, and they are not all our fault.

Mr. CALDWELL. Right.

Chairman GIBBONS. But this could go a long way to exacerbate some real problems on what has been generally peaceful, and I think it would still remain peaceful, but a turbulent border problem. Our United States-Canadian relationship is probably at the worst level it has been in my service in the Congress. I am not blaming that on us, nor necessarily on the Canadians, but it is a problem.

Listening to your testimony, you seem to be advocating that we move away from the income tax and toward some kind of tax on consumption. Have you had a chance to think that through? Is that your opinion, or am I misstating your opinion?

Mr. CALDWELL. That may be a broader conclusion than I intended to leave. I guess what I am really saying is as we move in international trade, the whole tax structure that we have now doesn't compete very well with the tax structure that we have to deal with on the international trade side. Trying to be pragmatic about it, I would think that maybe we should search for some means to cope with the problem without really trying to reconstruct the whole tax system in the United States, because I don't really think that will happen overnight. And I don't know the broader consequences of that. I am not sure that I would want that to happen.

As Mr. Pease suggested, we certainly could start looking at the GATT rules. I understand that there was quite a debate about this in the Tokyo Round, this very point, as to whether there could be some kind of rebate arrangement for taxes in our case, when we are dealing in international commerce. That would seem to me to be more practical to take this problem on in a more specific way than to try to really reconstruct the universe.

Chairman GIBBONS. We have battled this value added tax or direct tax versus indirect tax in the GATT, and we have battled it in our informal negotiations with the Europeans, not so much with the Japanese, but their system is more of a hybrid than the Europeans.

Mr. CALDWELL. Right.

Chairman GIBBONS. And frankly, they tell us, well, you are not going to tell us how to change our tax and we are not going to tell you how to change your tax. If you want to change it, fine, but we are not changing ours, and we are not changing the rules.

I recognize it as being a very important thing. I have pointed it out many times in the debate on trade policy, but we have not made any progress so far. I am afraid we have come to the position where we are going to have to change our policy, because we can't get the rest of the world to change.

Mr. Frenzel and I have been trying to change it a little, but we will take that up with you later rather than try to go into it fully here.

Let me ask you another question. Would improving the labor-management relationship be helped if the Congress gave you greater tools by which you could perhaps involve your work force in the equity ownership of your business?

I am not talking about on a mandatory basis but on a voluntary basis.

Mr. CALDWELL. I don't think that is a legislative matter. I don't really see that it is necessary to have any action by the Government. You know in our last contract we now have a provision for profit sharing.

Chairman GIBBONS. Yes.

Mr. CALDWELL. And that seems to be the other side of this whole spirit of cooperation. That is where the payoff would come from, and that was done between the parties, and it seems to me quite adequate.

Chairman GIBBONS. I was thinking about something a little broader than that. Now if you pay a worker a dollar, of course you can deduct that as a business expense, but if you pay a worker a share of something, you cannot deduct it as a business expense.

Mr. CALDWELL. I see.

Chairman GIBBONS. Would it help you and would it be—and I realize I am throwing this at you for the first time, but you have challenged us to come up with some better ideas and I want to try to respond to that. Would it help if we made, on a negotiated voluntary basis, or just on an individual voluntary basis, the distribution of common stock to workers with some kind of restraints on it, because we realize there would be tax problems there—an option that the companies could look at?

Mr. CALDWELL. I think we ought to look at it. This obviously is a pretty complicated subject that we are dealing with.

Chairman GIBBONS. It is complicated.

Mr. CALDWELL. I think we should look at it. Of course, there are, what do you call them, ESOPS now, I believe?

Chairman GIBBONS. We have ESOPS now, which is very complicated. We have the stock option plans for people in the management area, but I was thinking about something that we could do for the rank and file that would give them the same kind of interest that the Japanese worker apparently has in the well-being of his company over the long haul.

I don't want to emulate the Japanese, as I have said before, but where they have a good idea I don't mind trying it out. I was just kind of throwing that one out on the table.

Mr. CALDWELL. I think what the Japanese have is a feeling of responsibility up and down, and that to me is the heart of it. To the best of my knowledge, Japanese workers are not involved in stock ownership. I am not aware of any cases of that, but they have other ways.

Chairman **Gibbons**. I don't want to involve you in a long discussion about this, but I think you have challenged us to come up with something better. The Japanese worker gets a lot of his loyalty because if his company doesn't succeed he doesn't get a bonus, and if he doesn't get a bonus, he is really in bad shape.

Mr. **Caldwell**. That is correct.

Chairman **Gibbons**. And also the Japanese worker is loyal because if his company doesn't succeed, his pension is going to be very bad. Where our pensions are separated really from company performance by the laws that Congress imposed, I was looking for perhaps another way that we could interest the worker in the long-term significance of his company by giving him—not free—but he would be paying for it because he would be giving up pay and receiving common stock as a substitute for part of his pay—some kind of long-term interest in the profitability of the company, an American solution rather than a Japanese solution to the problem.

Mr. **Caldwell**. There is no doubt that pursuing that objective is something that we all ought to put our best minds to, because that is fundamental.

Chairman **Gibbons**. We are first the Tax Committee, in addition to the Trade Committee. Would you rather as a business manager have something as simple as a common expensing of your equipment as you bought it, or when you could take that expensing, rather than our rather complicated depreciation and investment tax credit system?

Mr. **Caldwell**. I like the idea of simplicity, and I like the idea of getting the exposure off the books as quickly as we can. Those two characteristics appeal to me very much.

Chairman **Gibbons**. We will explore that further on. I appreciate that.

Is the problem of Ford really Japan, and is the problem of the auto industry really Japan?

Mr. **Caldwell**. I think that is basically right. I don't see any other elements where the competition is really tilted to an unusual degree. I don't see it with the Europeans, for example.

Chairman **Gibbons**. I am not just talking about a competitive factor. Of course, if we could eliminate them, your problems would certainly go away.

Mr. **Caldwell**. I wasn't meaning to eliminate them. I was just trying to say, Where is the race? To the swiftest.

Chairman **Gibbons**. Yes, I see your point.

Mr. **Caldwell**. That is where it is, I think.

Chairman **Gibbons**. The other day either the USTR or Secretary Baldrige pointed out to us a fact that should have been obvious a long time ago and I just hadn't thought of it in that way. That while the consumption of American cars or cars in America had dropped by 4½ million from 1978 to today, the Japanese sales in of our market increased by only 450,000 units during that time, or about a 10-percent drop in consumption can be attributed to imports.

While it is always comfortable to blame somebody else for our mistakes, and believe me, I have done it quite often in my own life, I just wonder, is Japan really the problem?

I notice you said the industry had to spend $80 billion in catch-up.

What made it impossible for the industry to keep up? I am asking you to throw some barbs at us. Why did it have to be done on a crash basis rather than on a continuous modernization program in the industry?

Mr. **Caldwell.** I think it is easy for us to forget a number of circumstances that led to the problem we are in. I like to use the word not catch up but convert. As you know, this country pursued a low-cost gasoline policy. I am not saying it is good or bad. I am just saying it is a fact.

You know that this country is a huge country. It has a huge road network, and we are a very mobile population, so our whole heritage of motor vehicles was based upon those facts, and we also had an economic capability to indulge our desires and our interests for bigger cars.

Consider Japan—it is a nation about the size, physical landmass about the size of California, has 117 million people in that landmass. Only about 30 percent of it is usable because the rest of it is so mountainous. They had no such heritage, and they also were paying sort of the world price for gasoline, so they never had anything but small cars. So when the oil situation changed so dramatically, we became a major importer of oil, others controlled our sources of supply for oil, and we had oil interruptions, we began to pay the world prices for oil. The whole economics of motor transportation changed, and that required—uniquely in this country, it didn't require it anywhere else in the world—us to have to reconvert an industry from size A to size B, and this is a huge undertaking.

Neither the Japanese nor the Europeans were clairvoyant. That was just their heritage, and the economics of motor transportation that they grew up with was quite different than that which we grew up with, and then you add to that the fact that we undertook as a nation—I am not being critical, I am just reciting the issues here—we undertook as a nation a great degree of control over automotive design in the areas of safety and emissions and other qualities as well.

We had coming together three things all at one time: the need to reconvert from size A to size B, the need to cope with the change in the expectations and desires with respect to certain qualities having to do with safety and emissions of the vehicles, and the first 4-year recession that we have had since the thirties.

Those three things all came together at one time. And that combination of factors has been unique in all history.

Now, I am not passing judgment as to whether we should have foreseen this or shouldn't have foreseen that. I really would rather not engage in that kind of analysis, because I am not sure how productive it is, but the sum total of all this required just huge changes.

Let me illustrate. If you will let me correct the record with some specifics, because I don't have them right here——

Chairman GIBBONS. It is always our policy to turn the record over to the witness and let them make changes.

Mr. CALDWELL. I would like to make the point and I don't have the data at my fingertips. The industry as a whole in the United States and Canada has had to reconvert something like 270 factories, huge factories. Let me give you an illustration of what one factory is.

For example, the factory for the engine that we put in the Escort car. The four walls are still there. We put two wings on the plant. Everything inside that plant, absolutely everything, was gutted and new machinery and equipment came in. This is one engine plant. You have solid machinery, a third of a mile in one direction, a third of a mile back, a third of a mile down again to produce in that one plant. That is the magnitude of what we are talking about.

For some reason, this reconversion process has not been understood by the American people. If I could be a little self-serving about it, sir, I do think that it is really one of the greatest achievements that has ever taken place in industry anywhere, and hardly anybody understands it. But that is just one factory.

Every factory isn't like that, but many of them are. They are huge conversions. And at the same time, of course, new technology is being put in those factories as you go. The design is all new, and everything except the air in the tires is new in design.

The efficiency of the product has been upscaled. Our fuel economy for the national fleet is almost twice what it was in 1975. And we have had the rise of a third major production source in this world for motor vehicles. We forget that as recently as 1960 the United States made more cars and trucks than the rest of the free world combined. That was 20 years ago. Today we are third, behind Japan and Europe.

Japan has the capacity for about 12 million cars and trucks and a domestic market of 5 million. We produced in this country about 8 million vehicles last year. Think of it—only 8 million and they produced about 11.5 million. So the whole economics of motor vehicle production has changed. The markets have changed and it all came in a very short period of time.

I feel that some days we are seeing a movie in fast motion—I am sure there are a lot of mistakes—but I don't think we ought to overlook the fact that a lot of achievement has taken place. We ought to take note of it and pride in it.

Chairman GIBBONS. Your industry has made about an $80 billion change.

Mr. CALDWELL. It is not finished yet.

Chairman GIBBONS. I am trying to lay a predicate here for this next question, and I don't want to put you on record as coming out in favor of a gasoline tax, so don't—but let me. Since we are also the Tax Committee we have to think about these things. Since our roads are falling apart, and there is a reluctance here on this committee and in the Congress to do anything about it, we have you converted, $80 billion worth committed anyway from A to B, from big car to small car, to fuel efficient car.

Really today the price of gasoline is no greater in actual terms than it was when all this revolution started, because the price of gasoline has come down. What is going to happen to your industry when the American consumer catches on that it is really no more expensive to buy gasoline today than it was, in constant dollar terms, in the late 1960's?

After you have made that $80 billion change?

Mr. CALDWELL. You said something about roads, were you going to relate that fact to roads?

Chairman GIBBONS. Do we need to levy a gasoline tax to increase the durability of everybody's car on the road and to move the traffic that we have?

Mr. CALDWELL. We certainly need to fix the roads, I agree with that.

Chairman GIBBONS. I guess my real question is what is going to happen to your $80 billion when people find out that in real terms, it is not costing any more to buy gasoline today than it did in 1967?

Mr. CALDWELL. If I am understanding the sense of your objection and your question, I think I would consider it a favorable demand factor for the market.

Chairman GIBBONS. Are they going to go back to the A car?

Mr. CALDWELL. No, I don't believe so. No, I really don't. I think people have learned something out of that. I really don't believe that. This is frequently discussed and you read about it in the press, but let me try to put it in perspective.

The large cars today are only about 10 percent of the total market. So someone says well, we have a 10-percent increase in large cars. It is not significant. The change has been permanent. I do not think that we are going to have a big swing back. Too many people have learned that—and the efficiency of the cars has improved dramatically.

Chairman GIBBONS. I agree.

Mr. CALDWELL. Not only in gasoline use but in the use of space.

Chairman GIBBONS. Instead of coming at you indirectly, perhaps I should have [illegible] read in the paper that the large car lines are running overtime and the small, compact cars are running undertime.

Mr. CALDWELL. Right.

Chairman GIBBONS. Why?

Mr. CALDWELL. Well, simply because we are not producing nearly as many in total as we should.

Chairman GIBBONS. Of large cars?

Mr. CALDWELL. No, I am talking about cars in total.

Chairman GIBBONS. My question was, I read in the newspaper——

Mr. CALDWELL. We cut our capacity way back. You know, we used to have seven or eight plants that would assemble large cars. Today we have one. So the one plant has to run overtime, you see. But the change is fundamental, and I don't see it changing back.

Chairman GIBBONS. Thank you.

May I say, I am sure others will have questions, I appreciate your coming today. You have been a very excellent witness and a very patient person.

I realize your family probably doesn't get to see you perform like this. I know they are proud of you. We are happy to have them with us.

Mr. **Caldwell**. It is the only way I get to see my family.

Chairman **Gibbons**. We won't try to make a habit out of this, but any time you want to come back, let us know.

Mr. Bailey.

Mr. **Bailey**. I have felt very lonely in this Congress in many different forums in pressing some of the arguments that you made today. Coming from the horse's mouth it is much more authoritative than it would be for me because it is a matter of opinion on this side. I am particularly grateful for the remarks that you made concerning the challenge faced by the automobile industry in the United States given the reaction to the embargo on foreign oil and the resultant change in prices, the reaction of OPEC policies that resulted again in consumer preference changes.

It is very important to know as a footnote to what you said that as a producer out there making automobiles you are not in the business of forecasting or gambling with investment money or with merchandizing decisions that you have to make every day on the possibliity that the U.S. Government is beginning to follow some particular course with its policy or that OPEC is going to do something different the next day.

In short, from day to day and year to year it is your job to try to produce automobiles that people want to buy. The truth of the matter is before that crisis hit that is exactly what you were doing and you were doing it very well. I want to compliment you for it, when it is all said and done, you are not going to get credit for it.

I am confident that it will be a tribute to American management, initiative, our workers in this society and government too, and the response will be positive. I had incorrectly interpreted your views. I find myself very much in accord with them, some of the conclusions concerning this legislation. I think perhaps we have come to that point a little before maybe you think that we have come to that point.

I must sound prejudiced or something, but it makes me angry and I don't feel that way. I would like to extend a friendly hand and say let's go out and see who wins the ball game. I do think this legislation is a sad response and it is a very poor one, but it is the only game in town.

Incidentally, that 2-year period or so before it really takes effect I think is one of its best features, because I think until we do something in this Congress, the Japanese who monitor this system will continue to think it is going to be a matter of administrative policy or congressional leadership policy that decides what is happening in this country. What is going to go wrong is the Japanese are not going to respond until there is a public reaction and then you end up writing law that is really difficult to change.

They might be good at instituting changes in their factories, when it comes to industrial applications and industrial engineering and I admire them for it, but politically if they had any brains, I would beg and plead with them to try to change public attitude, so that their government leaders will respond.

Because there is a world out there reacting to the Japanese approach and it is unfortunate because they are such a bright and capable people and it is such a necessary democracy.

But they have got to change their policies, and that is all that this bill is about. I just cannot tell you how grateful I am for the statement that you made and the comprehensive approach that you took to this thing. I just deeply regret that it is not publicly better known. When the history is written, Ralph Nader will fade away quietly—there are good points that he raised. I happen to think that the safety changes will end up being beneficial and I think his type of approach should be complimented for that.

But taken as a whole, the preoccupation with the very bad attitude in this country that we have seen over the years I think is changing and we are getting back down to some basics, a little more commonsense and that type of thing. I think the history will show that you folks have done a great job of adjusting. You will get credit for it when it is all said and done.

Mr. CALDWELL. Whatever credit there is, it is a team operation. The credit belongs to a lot of people. Thank you.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Mr. Chairman, I want to pick up on a question that you discussed with Mr. Caldwell with respect to the Canadian agreement. One of the complaints of our Canadian friends is that Japanese productivity investment into the United States as this bill is calculated to do and as your testimony indicates you think it would, the Canadians will be left out. They have higher unemployment than we do. Obviously the Japanese are not going to build a plant in Canada. They will penetrate the Canadian market most likely out of the American production.

Is there any way that Canadian unemployment can be benefited through that agreement or elsewhere so that Canadian employees don't have to pay a greater price for Japanese investment in the United States?

Mr. CALDWELL. I am operating on the principle that the trade pact would continue. Now, the chairman suggested that maybe that might not be the case, and if that is not the case, then I think we had better take a look at the consequence of that, because I hadn't really contemplated that.

On the assumption that the auto pact continues, then I don't see how Canada's interests would be hurt because the balancing aspect of the Canadian agreement itself is somewhat rigorous. It certainly is very rigorous at this particular time.

But if in fact the bill would—if enacted—wipe out that trade agreement, I would like to go look that one over again. It has been our feeling that it is a healthy development to have North America considered as one market. In effect that is what it is all about.

Now there again, the currency problem is a pretty sticky one between the Canadian dollar and the U.S. dollar, and if you happen to put your factory on the wrong side of the border in relation to your market, you either win or lose. But nonetheless, I think the movement of those two currencies is a different issue than the Japanese currency issue.

Mr. FRENZEL. I think it is, too, but I like you want to pay some attention to where those jobs go. I know a number of people like yourself have suggested a common North American market. It appears to me, too, but I guess we are far away from achieving that.

I would like to go back to your suggestion on voluntary restraint. I was one who did not like the concept of voluntary restraint. Once it is in place, however, I would agree that it has prevented disruptions which probably would have passed this bill long ago.

If that is to be one of the alternatives, I guess I can swallow my philosophy a little bit on that. How far does it have to be extended at a minimum to do what you think is necessary?

Mr. CALDWELL. I think there are two factors, but I am not sure I can put a time dimension on both of them. One is for the retooling to be—well, you are never complete, but essentially complete, and that is mid-1980's. On the second one, until the economy—this means the employment that goes with it—can be brought back into a more normal range, and that is more difficult to predict.

Sitting here right now, I don't know now to predict that. There are many factors that are very positive with respect to getting auto demand up except for one—the confidence factor hasn't yet come to the fore. You can read in the paper this morning that there was a good 10 days, but we shouldn't be misled by that, because we all cut the prices severely to wash out the 1982 models and that is not typical.

But I guess I have to say my judgment would be mid-1980's.

Mr. FRENZEL. Mid-1980's? You can predict the one cycle and when you get done with the retooling you cannot predict the demand cycle?

Mr. CALDWELL. Not so much. You have to come to some sort of a judgment, even though it is hard to do, and I guess my judgment would be mid-1980's.

Mr. FRENZEL. I want to close, Mr. Chairman, with the same kind of compliment. We will probably send him back home with a large head. The auto industry has taken a lot of abuse lately, so you can probably stand compliments.

In addition to your fine testimony, your company has been running ads in my area where you have I think your smallest plant——

Mr. CALDWELL. A very good one, though.

Mr. FRENZEL. St. Paul, Minn., where you have had your employees on the radio asking people to come in and see how they build the cars, see how they work and what happens, and that has been just a splendid campaign. I know the people in my area have a good feeling that they have been invited in and a good feeling about the comments of your employees who run everywhere from the plant management down to a broom pusher. And the employees, unless they are terribly good actors hired for the part, and the radio assures me they are not, are enthusiastic about the program.

Mr. CALDWELL. They are.

Mr. FRENZEL. I think that is going to have some effect in restoring the confidence that you are talking about. I think it is a splendid program and a lot better than most of the advertising I hear on the radio for vehicles.

It has been well received, I want to tell you.

Mr. CALDWELL. Thank you.

Chairman GIBBONS. Thank you, Mr. Caldwell. We appreciate you coming this morning.

Mr. CALDWELL. Thank you very much.

I would like to say that I appreciate the opportunity to have a serious discussion about serious issues.

Chairman GIBBONS. You are always welcome.

Mr. CALDWELL. I appreciate that very much.

Chairman GIBBONS. Gentlemen, I would like to have your opinion as to what you want to do. We have the vice president of Volkswagen here. Would you want to continue on?

All right. We will go next to the vice president of Volkswagen, Mr. Philip Hutchinson.

Mr. Hutchinson, we welcome you. We appreciate your coming. You may proceed as you wish.

STATEMENT OF PHILIP A. HUTCHINSON, JR., VICE PRESIDENT, INDUSTRY-GOVERNMENT RELATIONS, VOLKSWAGEN OF AMERICA, INC.

Mr. HUTCHINSON. Thank you, Mr. Chairman.

I have a very brief statement which I would like to read.

Chairman GIBBONS. Go right ahead.

Mr. HUTCHINSON. I am here at your request in order to present the views of my company on H.R. 5133, the Fair Practices in Automotive Products Act.

Volkswagen of America is a U.S. corporation chartered in New Jersey with corporate headquarters in Washington, Mich. Volkswagen of America is a wholly owned subsidiary of Volkswagenwerk AG of West Germany, one of the world's largest automobile manufacturers.

During the current debate on local content legislation, Volkswagen has often been cited as a positive example of a foreign automobile company which has established manufacturing operations in the United States. It is appropriate at this time to discuss the reasons why Volkswagen decided to build cars and trucks here since the purpose of the bill as envisioned by its proponents would be to stimulate other automobile companies which are currently importing vehicles to locate manufacturing facilities in the United States.

Volkswagen of America was organized as an importer of Volkswagen products in 1955, 6 years after the first two VW Beetles were sold in the United States. Our sales were 35,851 units in 1955, 162,037 in 1960, and we reached 357,144 units in 1965. In 1970, the United States VW organization sold a record of 583,000 Volkswagen, Porches, and Audis, but that year marked the end of the company's impressive sales growth as a new factor in the import business equation had to be considered. In 1971 the exchange rate of the U.S. dollar compared to the German deutsche mark began a course which caused the price of German products to rise. As the value of the dollar declined, VW's competitive position in the American market deteriorated sharply. This was a classic example of price elasticity where increasing retail prices of VW products resulted in decreasing sales. A VW Beetle which sold for just under $2,000 in 1972 rose to $3,500 in 1975; the same car, $1,500 price difference. While not all of the per vehicle price increase can be attributed to dollar devaluation, this accounts for most of the added cost. Overall, Volkswagen sales fell from 485,645 cars to 267,730 in the same period. Volkswagen's share of the U.S. market dropped from a peak of 5 percent in 1970 to 2 percent in 1976, with a corresponding decline in profitability for the manufacturer and over 1,000 U.S. Volkswagen dealers.

For Volkswagen to be competitive in the U.S. market, it became clear that we would have to build cars here using a high percentage of local parts and labor. Slightly favorable U.S. labor costs compared to those in Germany, the high productivity of American automobile workers, the availability of competitive suppliers, and reduced transportation costs were also factors that were considered. In April 1978, the first U.S.-built Rabbit rolled off the line at VW's new assembly plant located in Westmoreland, Pa., a plant which has a capacity for over 200,000 cars a year. Volkswagen's other manufacturing facilities in the United States include a stamping plant located in South Charleston, W. Va., which not only supplies the Pennsylvania plant but also stamps parts for a factory in Mexico and a plant in Fort Worth, Tex., which manufactures automobile air-conditioners. This plant supplies all the air-conditioners for the German VW products.

The message to be garnered from this brief review of the reasons why Volkswagen located manufacturing operations in the United States is that we came here to reverse a downward trend in our business caused by factors that we could not control as an importer.

In sharp contrast to this situation is the philosophy embodied in H.R. 5133. The bill requires auto companies that sell in the United States to manufacture and source here even though it may not be competitive to do so. We believe that it makes business sense to invest where your markets are providing the company remains competitive. Even before we began our U.S. manufacturing operations, we purchased American materials and components when the price and quality were competitive. But we do not believe it is good public policy nor does it make sense from a business standpoint to force foreign automobile manufacturers to build plants here when the economic factors underlying the decision point the other way.

At the present time, the Japanese auto companies can produce cars that appeal to a significant number, but not all, of American automobile purchasers at a productivity rate and wage rate substantially below that for U.S. manufacturers, including Volkswagen of America. The actual numbers in terms of production hours per car and average labor costs and the reasons for the Japanese advantage have been well documented in several recent and ongoing Government studies.

The issue then appears to be, looking at H.R. 5133 in its narrowest sense, whether or not the Japanese auto manufacturers or any foreign manufacturers having an apparent competitive edge should be forced to change their way of doing business by means other than the pressure of market forces.

Volkswagen changed its way of doing business here at great expense and at great risk because of international market factors. We are proud of our efforts to produce cars here and we remain optimistic that we can regain the 5-percent market share that we had in 1970.

If H.R. 5133 were law today, Volkswagen would marginally exceed the domestic content ratio requirements. However, we could come under intense pressure not from our competitors or from consumer demands, but from the requirements of a local content law if unforeseen events dictate that our best course of business action would be to emphasize imported cars or components in favor of our U.S. produced cars.

For example, if the deutsche mark were to strengthen against the dollar as it has in the past, we could very easily be out of compliance. Another example: Suppose we sought to increase the demand for a particular model to a degree that would justify U.S. production. This would be done through imports until the volume reached the level where economies of scale would justify production. Yet, the bill would hold us to our current level of imports, thereby restricting our long-range goal of expanding U.S. production capacity.

In conclusion, Mr. Chairman, I would like to say that we are concerned about the high unemployment in the auto industry. We have good workers on layoff, workers who would be rehired tomorrow if the demand for our products was there.

The U.S. economy is on the verge of a comeback, in our opinion. Interest rates and inflation are down. It is up to VW to position itself for the turnaround with competitive products. Building a wall around this country will not help us compete with the Japanese or with other manufacturers. We compete in a worldwide auto market and need the flexibility to buy in Mexico, Canada, Germany, and the United States, wherever the best quality and prices prevail. To limit this flexibility by enacting H.R. 5133 will jeopardize Volkswagen of America's U.S. operations and hinder the reemployment of our workers as well as the creation of future job opportunities.

Mr. Chairman, thank you for the opportunity to present these views.

Chairman GIBBONS. I want to thank you. You have taught me a lot in 15 minutes here because it is obvious from your statement on page 4 that if what will help Mr. Caldwell takes place, that is, an appreciation of the Japanese yen versus the U.S. dollar, the deutsche mark is probably going to go up against the U.S. dollar. As a result, you would be out of compliance, and with this law hanging over your head, you are certainly not going to expand your operation in the United States.

Mr. HUTCHINSON. That has us very concerned. We have done the calculations at different exchange rates, and have found that just under the terms of the law we would not be in compliance if the Deutsche mark, for example, were traded at 2 to the dollar as compared to 2.5, where it is today. Just 18 months ago or thereabouts it was trading at 1.75 to the dollar, so it is not a farfetched scenario.

Chairman GIBBONS. So your incentive and the incentive for any other manufacturer to move into this market and start employing people and building here is zilch; isn't that right?

Mr. HUTCHINSON. No, our incentive is——

Chairman GIBBONS. I mean if we enact this law.

Mr. HUTCHINSON. We are here for the long term.

Chairman GIBBONS. Sure.

Mr. HUTCHINSON. But it just limits our ability to expand any further. In fact, it may cause us to constrict what we are doing rather than to expand it.

Chairman GIBBONS. I don't have any further questions. I understand it. You have helped me a lot. Mr. Bailey.

Mr. BAILEY. Phil, my good friend, you have to help me a lot on this argument. You are good folks to work with and I personally welcome you here. I was teasing Mr. Pease. I said when you made that offhand reference to the plant being in my district you didn't sound too happy about that particularly. I got sort of a kick out of that.

I have had an opportunity, as you know, to work very closely with you people. I have enjoyed that, Phil. I got a pen from President Carter concerning the fleet average. I have enjoyed working with you.

I do disagree with you, though, and I think if I could have the chairman's attention, and Mr. Frenzel's attention. I am trying, Mr. Chairman, a couple of points that I would like to make for your benefit, because I think they are awfully important.

Phil, I did a little figuring with Dave Flanders of my staff, who does an outstanding job. Right now on the computations under the Ottinger substitute, you would run at about 40 percent, under that bill today, and the way you are selling cars right now, you are at about 3 percent, the way I figured it up.

In short, what it means is that you are under, significantly under, about 15 percent when you look at the percentage relationship between 34 and 40 under the minimum requirement in the bill today. You don't dispute those figures, do you?

Mr. HUTCHINSON. No, sir. The way that we figure our content, we have to average the content that we have in our U.S.-produced Rabbits that are built in your district. We have about between 70 and 75 percent content in those vehicles, and we average that content with the cars that we import.

Mr. BAILEY. Right.

Mr. HUTCHINSON. And with the Porsches, Audis and other Volkswagen products, we are in the 40 percent range under the terms of the bill. Regarding the formula in the bill, though, there are really two formulas. You either go through this computation or you divide the number of sales by 10,000 in the year to figure out what your content ought to be.

You have to take the higher of those two figures, and consequently we have to take the higher figure under the formula, and though we are in compliance today, we wonder about the future.

Mr. BAILEY. You are fearful about the future?

Mr. HUTCHINSON. Yes, sir.

Mr. BAILEY. Let's go out there to maybe 1986 or so. Maybe you are fearful there, because what you would like to do is to be selling better than 400,000 units at that time, and maybe that is the cause for your fear, but I don't think it is well-grounded. I do disagree with you, by the way, and after having done a little homework on this issue, I understand where you are coming from and that kind of thing. But I do respectfully disagree.

I wonder about one thing. Up in Michigan, you produce parts of the power train, do you not, for some of your vehicles?

Mr. Hutchinson. No, sir. We do not have a power train facility here in the United States.

Mr. Bailey. Mexico, I take it back. I am wrong.

Mr. Hutchinson. Yes.

Mr. Bailey. But you have a plant up there that you plan to open, don't you?

Mr. Hutchinson. We have a second facility at Sterling Heights, Mich., which is about 90 percent completed. We had hoped that it would be in operation by now.

Mr. Pease. Would the gentleman yield?

Mr. Bailey. I yield to the gentleman.

Mr. Pease. I apologize for butting in, but I was particularly intrigued by the status of the Sterling Heights plant. I will wait for my own time to find out about that.

Mr. Bailey. You won't have to, if the gentleman will let me finish. I would be very happy to complete it for you.

On that plant you and I had some private meetings when we discussed, if you remember, some of the issues surrounding the location of the plant.

Would you add to your response concerning that plant and when it comes into operation, any figures that you might have or any work that you may have done on the domestic content impact that it would have on your fleet average?

Mr. Hutchinson. It would have a very favorable impact were the plant to be opened. Unfortunately, we are in the position now that our plant in Pennsylvania is running at only between 40 and 60 percent of capacity.

Our management has in effect put the Sterling Heights facility in mothballs, because obviously if we can't run one plant at capacity, we certainly can't look to another. We don't see the demand for our product in the next year or so such that would justify pressing on with the Sterling Heights facility.

Mr. Bailey. I just wanted to say to you that, in response to Mr. Pease's anticipation, that I am very much concerned and was very much concerned with that plant and its domestic impact content via this legislation. In fact although you know we have spent just a little time discussing it, we had worked very quietly and very hard to insure, and in fact you will remember a news article that was put in the Pittsburgh Press where you and I were quoted.

I said those things are going to be taken care of and they have been taken care of. I just want you to know, and I think it is important to stress, that Volkswagen of America and the confidence you have expressed in this country and in us, and the concern that we have had in modifying this legislation are aimed at protecting someone who has shown that confidence in the United States, and I think you are to be complimented for it. But I do want you to know that the bill was specifically designed to respond to that difficulty.

Mr. Hutchinson. We understand that, Mr. Bailey.

Mr. Bailey. Yes.

Mr. Hutchinson. I know that the sponsors of the legislation, the United Auto Workers, and many Members of Congress have bent over backward to recognize Volkswagen of America's interests here, to protect them. We can only deal with the bill as it is, as we see it today, and we are trying to give you our best assessment of what the impact of that legislation would be on us.

We see it as restricting and decreasing the flexibility that we have to be a profitable company here in the United States, and to create jobs in Pennsylvania and in Michigan. We are sourcing outside of the United States in some cases. We prefer to buy here, but it is more competitive at other places. Therefore, we have to bring that material in from outside. That helps to create jobs in Pennsylvania.

Mr. BAILEY. Right.

Mr. HUTCHINSON. Under the bill, though, we would be restricted from doing that, if it had an impact on that formula. We just wouldn't have the flexibility.

Mr. BAILEY. Again, I understand philosophically where you are coming from, and of course I do disagree with the substance of your objections, because I think the way the bill is designed, I think it very clearly responds to them.

Furthermore, I would have to say that when—and I would hope within a few years, a couple of 3 years at least that plant is opened, under my figures it would take you well out of any kind of a problem area.

I think it is important to get that on the record, because the changes that I encouraged and requested among others was done with that in mind, and I think it is awfully important to get that on the record.

Mr. HUTCHINSON. If the volumes were there that you have stated, it would go a long way to allaying the concerns.

Mr. BAILEY. Any possible fire, right.

Mr. HUTCHINSON. Yes, sir, but we have to deal with the market projections that we have made, what we think is going to happen to the market, and those are the projections that our concerns are based on with the bill as it stands.

Mr. BAILEY. Phil, in another area briefly, I also want to compliment you for including in your statement the comments you made on American worker productivity. I know that when you folks came to the United States, and I am very proud of the fact that one of the major reasons you chose western Pennsylvania was a very serious study on American worker productivity. I am wondering if you could expound just a little bit, briefly on that.

Second, a statement that caught my eye, in your statement "slightly favorable U.S. labor costs compared to those in Germany." I think perhaps we misunderstand in this country, given the tools with which to work, that our labor is extremely competitive.

The Japanese situation has been compared often, and of course we are talking about situations there which I think most people recognize in modern industrial nations, it will probably change over time. Japanese workers at some point are going to say, "I am interested in a little more secure retirement."

They are going to say at some point, "I want more disposable income." They are going to mature as their society matures. They will change and probably move into a more competitive kind of an area. Although they do have some cost advantages now, that is true, but would you comment on that productivity issue for me.

Mr. HUTCHINSON. Of course.

Mr. BAILEY. You have been very kind to me in the past and I would appreciate it.

Mr. HUTCHINSON. First of all, the wage, the bottom line. When the managers of our German operation were looking at the United States, they were faced with a situation where the wage rates in Germany, the German metalworkers, were approaching that of the United States. They could see a trend where at some point the German metalworker would exceed the wage of the U.S. automobile worker, so that was a factor in the bottom line planning.

When our planners, though, came to the United States, we looked at virtually—I mean every State had made proposals for Volkswagen to locate there, and one of the reasons that we chose Pennsylvania was because of the strong work ethic of the people there, and also the productivity of the industrial workers not only in Pennsylvania but in America.

As you may know, the German worker has many hours of vacation, many days vacation longer than the U.S. worker. If you stake all of these things next to one another you find that the U.S. worker is in some cases more productive than his European counterpart.

Mr. BAILEY. At the risk of arousing my dear friend Mr. Pease, could I interrupt you for one second.

Mr. Chairman, you and Mr. Frenzel, please forgive me.

Chairman GIBBONS. You are doing so well I want you to keep on going all afternoon. I have enjoyed this witness. He has told me more in 15 minutes here than I have learned in 3 days of flogging the Japanese and the Americans.

Mr. BAILEY. He is a fine gentleman. He is very well informed. He is making some comments now comparing the wage packages and productivity and what not between Germany and the United States, and I think that many times we get the perception here that our workers, our unions are so far out in front that we are completely out of the competitive area, and I wish Mr. Hutchinson would just continue.

Chairman GIBBONS. The wage scales in Germany are comparable with ours.

Mr. HUTCHINSON. Yes.

Mr. BAILEY. He was commenting on that.

Mr. HUTCHINSON. I was just noting, Mr. Chairman, that in 1979, for example, the German automobile worker had a wage that was somewhat higher than his counterpart here in the United States, but when you compared the productivity of the American worker, the high quality of product that he turns out compared to that of the German worker at those wage rates, it comes on the plus side for America at the time that we made that decision. So the labor input was a very positive factor in our decision to locate here.

Mr. BAILEY. Thank you very much. I just want to finish up with a couple more questions. Volkswagen, of course, as a German company, has had a great deal of experience in marketing worldwide for many, many years, and has produced a very high-quality product with an excellent reputation, and the product produced in Pennsylvania is consistent with, I think, the management experience you people have.

It has been a very high-quality product. It has engineered some tremendous innovative changes in diesels, powerplant, et cetera, that I think really has been terrific.

Do you have a manufacturing facility in Japan, or do you merely market there, and I don't know, Phil, if you have any experience with it personally. Do you know about market entry problems or investment problems? Have you met resistance? We had some reaction this morning, you were here in the room, concerning the difficulty in investing in Japan.

The chairman made a statement about flogging the Japanese, and I am sensitive to the fact. I think it is a point well taken.

I want to say on the record that I do not harbor any kind of prejudice against the Japanese. I have spent time in Asia. Anybody that knows me knows that I have a great deal of respect for and interest in Asia, and I have absolutely no racial or ethnic prejudice inside me. As a matter of fact, I guess the admiration and respect and a desire to try to get Japan to get more into the defense area if we possibly could, and also get her to understand that that fantastic contribution of work ethic, of course, and energy that she has as a nation has got to pull together with everybody else.

There has got to be a degree of fairness, and the reactions I am hearing come from Europeans, from people all over the world is they are just feeling victimized. I don't think the Japanese mean to do it. It is their way of doing business or whatever, but they have got to learn and we have all got to learn to get along, as was said this morning, so that is my reason, and it is a very sincere reason.

It is not a disrespectful one and it is not a fearful one. It is one that has to do with my pride too. Naturally I have pride in America. I get a little tired of hearing America put down, quite frankly. While I don't want to put them down, I just want them to be fair.

What has Volkswagen's experience been, if you are familiar with it?

Mr. HUTCHINSON. Volkswagen is the largest importer in Japan.

Mr. BAILEY. Right.

Mr. HUTCHINSON. That is the good news. The bad news is that we only sell about 18,000 units a year there. We do build cars especially for the Japanese market, however, and do not have some of the same problems that the domestic companies have in car-by-car inspections. We do certify for the Japanese market much like our European cars are certified for the United States market. However, there are special requirements.

We have to modify our cars somewhat to meet the unusual requirements of the Japanese market, and we do that. We add kimono guards on the bumpers so that ladies' kimonos will not get caught. We widen the seat slightly so that it meets the requirements of the Japanese market. It is a tough market to compete in. We have a very high technology car. It is an expensive car even in Japan, and it is a car that the Japanese buy as a status symbol, as was pointed out earlier.

Insofar as actual production experience in Japan, we do have an arrangement with Nissan, which has not been fully consumated in terms of actual production. What we plan to do is to produce a car in Japan that is called the Santana, which is a Quantum here in the United States. It is a larger VW product, and we are looking forward to perhaps greater penetration in the Japanese market, and also we hope to learn something from the Japanese in this arrangement.

Mr. BAILEY. Why haven't you invested sooner? Why don't you? It just makes sense to me. If you look at everything, with the exception of probably individual worker productivity, where we are actually still a little bit better in this country, we still have a more highly skilled work force, I still think that our management overall really has better experience, better ability, I really believe that, but not at international marketing, I agree.

The thing is, though, if I wanted to manufacture somewhere, and I looked at markets, the Japanese market is not a bad one, I think I would want to go there and build a plant. Why haven't you?

Mr. HUTCHINSON. Well, as I pointed out, we have a very small volume in the Japanese market. We would like it to grow, and we have recently, within the last year or so, embarked on this arrangement with Nissan.

As far as why we haven't done that before, we haven't done it because we have had the capacity in Germany. We haven't done it because we have had capacity in other countries.

Mr. BAILEY. You don't feel you have met resistance then?

Mr. HUTCHINSON. I don't know of any resistance that we have met.

Mr. BAILEY. That is heartening, because mostly that is what we hear, that the place is very, very attractive, in order to invest, aside from those sectors of the economy where it is encouraged and allowed, otherwise it just depends. It is a choice kind of thing.

Mr. HUTCHINSON. The Japanese are also interested in our technology. As you probably know, the most fuel efficient car in America, that is sold in America, is built in your district.

Mr. BAILEY. By far.

Mr. HUTCHINSON. Fifty-mile-per-gallon car in the city.

Mr. BAILEY. That is right.

Mr. HUTCHINSON. Sixty-seven on the highway. The Japanese are interested in this technology.

Mr. BAILEY. Right.

Mr. HUTCHINSON. They are interested in our engine, and so it is going to be an exchange process.

Mr. BAILEY. I have taken a lot of your time. Again, Phil, I do disagree with you on this legislation for a multitude of reasons, not because I think it is a good solution in and of itself, but I think it is a response to a group of problems.

I think we have had so much testimony on that there is no need to elaborate. We have taken efforts to write this legislation in a way that it would not hurt you as a company, and personally, of course, again I am very happy to see you and welcome you here. Thank you very much for being here.

Mr. HUTCHINSON. Thank you very much.

Mr. BAILEY. Thank you for the good answers. Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. Hutchinson, I take it from your testimony that this bill will not inspire you to build new factories or hire new employees in the United States?

Mr. HUTCHINSON. No, sir. At the present time we have a factory that is only working at 50 to 60 percent capacity. We have a second factory that is almost completed. Certainly we are way out there in terms of our investment in the United States until this market turns around. Our U.S. sales at the present time are off in the 40 percent range. There are many reasons for this: The economy, the interest rates, the malaise that has caught up all of the other manufacturers.

We think that we are on the verge of a turnaround in some of these economic conditions. I saw in the paper this morning that the inflation rate was down to 3-point percent. This is certainly good news. This will restore consumer confidence, and we are hoping that when the economy does come around, we will be prepared with good products to expand the existing capacity that we have; in other words, to come up to full capacity in our Pennsylvania plant, and hopefully also to build cars in Michigan.

Mr. FRENZEL. And this bill will result in no new jobs at VW?

Mr. HUTCHINSON. We don't see this bill as encouraging VW jobs. We need to—let's go back in history for just 2 or 3 years—you need flexibility in the auto industry to buy wherever you can. When Chrysler was in the throes of trying to struggle for its life, it came out with two small cars, the Omni and the Horizon.

It couldn't build enough engines to meet the demand for those cars. It turned to Volkswagen and bought European VW engines for its product. It helped the Chrysler Corp. remain competitive. I think any company that wants to be competitive in this market has got to source in Canada, in Mexico, wherever it can find the best product. This will put people back to work. This will make the product viable.

Mr. FRENZEL. I think that is a very interesting observation. You have given me already three good ideas that I really hadn't thought about: The one you just made now, the one Mr. Gibbons made about currency fluctuation, and about where you are trying to establish the market.

It shouldn't come as a surprise to us, we have always said that about our operations in Europe and elsewhere, that if you are going to recapture the market you are going to have to do something where your strength is. It may be in Germany, it may be in the United States. Eventually that will result in production within the country in which you are selling simply because of the eventual wait of transportation, distribution, et cetera, but it takes time to do that.

Mr. HUTCHINSON. Yes, sir.

Mr. FRENZEL. And of course at a time of recession, with unemployment it is understandable that nobody wants to take any time, but Congress' usual method is to legislate blue sky and rain after dark for the farmers. Instead of legislating processes in really good schemes, we try to legislate results. I think you have been very good in showing us the results of this bill are likely to be somewhat different than the sponsors anticipate.

What is your percentage now in your Pennsylvania operation? Would you comply with this bill at the moment?

Mr. HUTCHINSON. At the Pennsylvania plant we have between 70 and 75 percent domestic content. That is content that we define as either United States or Canadian content. Considering all of our U.S.-built cars and all of the imported cars together, which we have to average to meet the formula in this bill, today we would be in compliance if this bill were law. Our concern is for the future, whether we could stay in compliance if this were the law.

Mr. FRENZEL. At the current rate, what kind of a currency fluctuation would knock you out of compliance, 5 percent, 10 percent, 20 percent?

Mr. HUTCHINSON. The calculations that we have done on the currency show that we would be out of compliance if the exchange rate were around 2 marks to the dollar. The rate now is at 2.5. Eighteen months ago, or 2 years ago it was at 1.75.

Mr. FRENZEL. It is well within the working range?

Mr. HUTCHINSON. It is within the range of possibilities, particularly if for whatever reason you find that you can't either locate the appropriate components or materials here in the United States and have to go elsewhere, that tends to boost the foreign content in your car. Naturally we would like to buy everything we could here, but if we can buy it at a better price in a comparable quality somewhere else, we have to do that as well.

Chairman GIBBONS. Will the gentleman yield for just a clarification here?

Mr. FRENZEL. I yield.

Chairman GIBBONS. Did I hear you say that you are in compliance because you are counting United States and Canadian content as being in compliance with this bill?

Mr. HUTCHINSON. I am giving you the figure of 70 to 75 percent domestic content. Under the definition of the so-called EPCA Act, which has a definition of content, it is that definition for the Pennsylvania cars. However, using the definition in the bill, we would meet for all of our vehicles about a 40-percent content level counting both Pennsylvania cars, imported Porches, Audis, and Volkswagens.

Mr. BAILEY. Mr. Chairman.

Chairman GIBBONS. You would flunk the test the way the bill is now written.

Mr. HUTCHINSON. No.

Chairman GIBBONS. Yes, you would. This bill does not allow you to count Canadian content as being U.S. content. This bill does not allow that.

Mr. HUTCHINSON. I may have misled you, Mr. Chairman. Using the formula in the bill, not counting domestic content, counting only the labor and materials and overhead in the United States as permitted by the bill, our overall fleet average would be in the range of 40 percent for both the domestic and imported cars.

I was using the 70 percent because there is another definition of domestic content that the Congress has enacted into law, and that definition is designed to distinguish between an import and a domestic car. If you go over 75 percent, domestic content defined as Canadian and United States content, you become an American domestic car. It may sound a little complex, but this is a law that we are dealing with that you and your colleagues have drafted.

Chairman Gibbons. This law supersedes the United States-Canadian auto agreement and the enabling legislation.

Mr. Frenzel. Not in the definition of the content, the definition of whether it is a foreign car or not.

Mr. Bailey. That is correct.

Mr. Frenzel. I guess I do understand that. Let me go forward. You talked with Mr. Bailey about wage rates, inviting our attention to that. What is the current comparison between average wage rates in your American plant and in your plants in the Federal Republic?

Mr. Hutchinson. The entry level wage at our plant in Westmoreland is on the order of $17.50 an hour. In Germany, because of exchange rates again, you have a wage that is in the order of $13 to $14 an hour. I would point out that only 2 years ago the German wage rate was higher than the domestic rate here, so it may not be an entirely fair comparison.

Mr. Frenzel. For the moment it is a little less, and in the past it has been a little more?

Mr. Hutchinson. Yes, sir.

Mr. Frenzel. You feel that they are roughly equivalent?

Mr. Hutchinson. Roughly comparable.

Mr. Frenzel. So your decision to come here was justified both by that relationship, the transportation cost, and the productivity cost which Mr. Bailey was discussing?

Mr. Hutchinson. We think so, and because of the quality of the car that we have been able to build here. We knew we would not be successful in the United States unless the quality of the Rabbit were as good as the customer perceived the quality of the European Rabbit. We are pleased with the high quality of car that our UAW partners in Pennsylvania have been able to put into our product.

Mr. Frenzel. Good. Does it bother you in your marketing plans that those automobile and steel wage rates are so much higher than the rest of the rates that manufacturing in this country—my constituents keep belaboring me and say how can I, a $12-an-hour guy, buy a car made by another chap who is getting twice that much?

Mr. Hutchinson. There is no question that the wage rates in the automobile industry, whether in the United States, Europe, Japan, they tend to be the highest rates, because they are hard, difficult jobs. When we came to the United States we felt that it was better that we not try to mold our U.S. plant on a European pattern, but rather take the technology, the German engineering, and mate that with the American work process, and part of that work process is a capable worker who earns a high wage rate.

Mr. Frenzel. Thank you. You have warmed Mr. Bailey's heart and mine, too.

Would this bill make it more difficult for you to sell cars in the United States because its sponsors claim that it will bring Japanese automotive production to the United States sooner?

Mr. Hutchinson. Well, the Japanese, they are tough competitors. We compete with them all over the world. We compete with them here. We would prefer to compete with them if they were building plants here, because they would have the same costs that we would have. But we can understand why they are not here.

Mr. FRENZEL. Why are they not here?

Mr. HUTCHINSON. For a whole host of reasons. They are not here because their wage rates are lower, they are not here because the productivity of the Japanese worker is just as good, perhaps better than the American worker, not because the workers are better but because the system there is different from our system. They have, for example, a very efficient supplier network. The suppliers tend to be grouped around the manufacturing plants, where we here in this country have long supply lines that go to our facilities. Their plants are running at capacity in Japan. They have a price advantage here. As a businessman, they are looking at this and saying we should try to preserve that and not go to where our costs might be higher.

Mr. FRENZEL. That is understandable. This committee has visited some of those plants, and it is true it is a whole different game over there, the satellite supplier plants located very closely and sometimes just across the street, very clever and highly skilled, highly timed delivery system, the parts coming into the factory. We have much to learn from them, but I agree with Mr. Bailey that we have much to be proud of here and we will be able to compete.

Have you ever built a plant in Brazil or Australia?

Mr. HUTCHINSON. Yes, sir. We had a plant in Australia; we no longer have it. We sold that plant in the mid-1970's. We were not able to build cars in Australia at a competitive scale. We also have a plant in Brazil. The Brazilian plant produces cars that are quite comparable to those here in the United States. In addition, they build alcohol-fuel vehicles in Brazil as well as gasoline-fueled cars.

Mr. FRENZEL. They have a domestic content law in both of those countries?

Mr. HUTCHINSON. Yes, sir.

Mr. FRENZEL. Did that have anything to do with your being in there or out of there, or did it affect you in any way?

Mr. HUTCHINSON. It affected the Australia operation. It was one of the factors that did not add to our competitiveness in Australia. There is quite a market in Brazil. We are not there simply for domestic content reasons. We are there because we want to take advantage of opportunities in Brazil, and also because there are economies of scale that allowed, for example, Volkswagen of America to buy, for a period of time, engines from Brazil that Brazil was unable to use in its own markets. Those are the same fuel-efficient engines that put Pennsylvania workers to work here.

Mr. FRENZEL. It is a great, large chain in the cosmic scheme of things. If we do it right, we are likely to put more people to work rather than try to lock up the place. I must agree with you there.

Mr. HUTCHINSON. Yes, sir.

Mr. FRENZEL. Do you export from Brazil, and did you export from Australia under a local content situation?

Mr. HUTCHINSON. Not to my knowledge. The plant in Australia was for the domestic market. In Brazil there is some export business to other countries, but it is mainly in the truck field.

Mr. FRENZEL. Again, thank you very much for your excellent testimony. I congratulate you for the job you are doing up in Pennsylvania. Thank you.

Mr. HUTCHINSON. Thank you, Mr. Frenzel.

Chairman GIBBONS. Mr. Pease.

Mr. PEASE. Mr. Chairman, I will be very brief. I would just like to thank the witness. I think you have been an excellent witness. You have given us some insights which will be extremely valuable as we consider this whole problem.

I want to make the comment regarding your selection of Pennsylvania as a place to locate, and if everybody else in that area is as productive and as hard a worker as the Congressman from that area, I can imagine that you are just churning out cars one after another at a very, very low cost.

Mr. BAILEY. Is that in the record? Does the lady have it? Thank you.

Mr. HUTCHINSON. Mr. Bailey is an outstanding and hard-working Congressman.

Mr. PEASE. Sometimes misguided, but outstanding and hard-working.

I will correct that in the record.

I just want to ask two questions. One, your plant in Sterling, Mich., will that be an assembly plant when it opens?

Mr. HUTCHINSON. That is an assembly plant that is roughly comparable to the Pennsylvania facility. It has a capacity of about 180,000 cars a year.

Mr. PEASE. Finally, I want to ask a little bit more about your competition in the Japanese market. You say you make up cars in Germany and ship them to Japan specifically for that market. Just out of curiosity, what percentage would be left-hand drive, and what percentage would be right-hand drive?

Mr. HUTCHINSON. My impression is that they are all the right-hand-drive cars, designed specifically for the Japanese market. There are some minor modifications that have to be made in Japan, but these cars are designed to meet Japanese emission standards and designed to meet the special safety requirements that they have there.

Mr. PEASE. Do you have any idea at all of what effect on the market price of the car your going to work on the assembly line in Germany is as opposed to doing it on a custom basis in Japan?

Mr. HUTCHINSON. The car is more expensive any way you do it. The Japanese consumer is a very finicky consumer. Everything has to be just so. Consequently, even though the car is especially designed for that market, it still has to be prepared to meet the consumer demands there.

Mr. PEASE. I guess what I am getting at is that when American manufacturers sell cars in Japan, they are essentially cars made for the American market, and they have to be customized, if you will, individually, in Japan. I am just curious to get some idea how much that adds to the cost of a car sold in Japan as opposed to doing it on the assembly line.

Mr. HUTCHINSON. It would add more to do it in Japan. There is an economy of scale. We sell approximately 18,000 units in Japan, and with that type of volume we can afford to do more at the factory. There is a basic difference between the American-produced car and our car. Our car is more along the lines of the Japanese competitors: It is small, highly fuel efficient, fits the road there, fits the size of the people. The American car tends to be somewhat different from that, larger, perhaps less fuel efficient, more of a status symbol car.

Mr. **Pease**. Did I understand you to make the comment a little earlier that from your point of view there are no barriers to your doing business in Japan?

Mr. **Hutchinson**. I am not aware of any financial inhibitions. I would have to check that for the record. I would be happy to supplement the statement. I do know that we have quite an amicable relationship with Nissan. We are establishing a toehold in that market with actual production there and we are hoping that it will benefit us by learning more about the Japanese system, and they are hoping it will benefit them by learning more about our high technology.

Mr. **Pease**. We hear a lot about nontariff barriers. Do you run into nontariff barriers where there are bureaucratic delays, anything of that sort which you would characterize as sort of unfair competition?

Mr. **Hutchinson**. I cannot cite any for the record today. There are different customs and barriers in every country that you deal in. If you go through our assembly line in Wolfsburg, West Germany, you will see cars with different-colored parking lights and peculiar features that have to be met if you want to sell in that market. We try to meet the demands of the Japanese market. Even though we are the largest importer there, the volume is very small. That is due to the long distance and price and so forth. If we want to sell there, we just have to meet the requirements of that market.

Mr. **Pease**. What about their dealer arrangement? I have heard stories in our area that they have a dealer arrangement in Japan where a dealer can sell only one car, so it makes it tough—one branded car, so it makes it tough for a competitor to go in and say to the Nissan dealer, why do you not handle Fords on the side or Chrysler or American Motors so we can build up to the point where we can import our own dealer? Do you run into that in Japan?

Mr. **Hutchinson**. I am not familiar with that in Japan. It is not dissimilar to what happens in Europe. One of the reasons that the Japanese have not been successful perhaps as they have been in this market is that in Germany dualing is not permitted. They have to set up their own distribution system and cannot key back on the network that is already established there.

Mr. **Pease**. Thank you very much. I certainly appreciate your testimony.

Mr. **Hutchinson**. Thank you, Mr. Pease.

Chairman **Gibbons**. This has been excellent testimony, sir, and we appreciate your coming here. We realize that you are in an uncomfortable position, as we realized that Mr. Caldwell was, too, in opposing this bill. All of the automotive manufacturers that I have had an opportunity to talk to are in an uncomfortable position. They have troubles with the UAW and do not want to exacerbate them, but all that I have talked to so far have given me the impression that this bill is a disaster for American industry.

Mr. BAILEY. No rejoinder, but a couple of questions.

I do not want to put you on the spot, and feel free not to answer this at all, if you would like. As far as domestic content requirements are concerned, we are talking here about a piece of legislation on which we may or may not disagree, really. The thing is, have you had an experience with other domestic content requirements in trying to do business in other countries?

Mr. HUTCHINSON. Yes, we have.

Mr. BAILEY. I do not want to put you on the spot, but would you like to comment?

Mr. HUTCHINSON. Well, we do business in Mexico, which has what we call performance standards that require a certain amount of export in exchange for establishing our operation there. We do business in Brazil, which also has a certain domestic content and export requirements. We are able to live with those systems. We do not favor them, because they are artificial and they restrict our full flexibility, but we are able to live with the systems, and because of worldwide economies of scale we buy from Mexico and Brazil here in the United States.

Mr. BAILEY. But you have been forced to locate manufacturing facilities in some countries, and I do not think you have named them all, but you have been forced to do so as a price of doing business there; is that correct?

Mr. HUTCHINSON. As a price of a part of the market. These are countries that are quite different from the United States. These are countries that either have a very infant industry or in some cases no industry at all. And the requirements for export in those countries might be viewed quite reasonably if you were trying to establish a fledgling industry.

Mr. BAILEY. It is OK there, but it is not OK here?

Mr. HUTCHINSON. That is not my point. Take Mexico.

Mr. BAILEY. Let us take industrialized nations. Let us forget Mexico.

Mr. HUTCHINSON. Let us take Canada.

Mr. BAILEY. OK.

Mr. HUTCHINSON. Recently we announced that we were going to establish a parts plant in Canada. As you may know, Volkswagen is not a participant in the Canadian auto pact, therefore any car that is produced in Pennsylvania that goes into Canada has to pay a duty. The Canadians in exchange for allowing those cars to come in duty-free have said if you will build a parts plant here, we will take that barrier off.

Mr. BAILEY. Did they ever talk about percentages in terms of content that those parts should reflect in a car?

Mr. HUTCHINSON. There is a formula that involves our total percent of sales in Canada. We have to have a certain percentage of content. Now, they will allow us to figure that on a worldwide basis, so that it does not actually have to be in the Canadian car, it can be in the German car or the American car.

Mr. BAILEY. When you came to building a manufacturing plant in the United States, did any Government official or any law sit down and require you to go into that kind of negotiation?

Mr. HUTCHINSON. There was no requirement for us to have content. That is one of the reasons why we located here.

Mr. BAILEY. I am glad to have the material concerning Canada on the record. You have to do business around the world. I would conjecture that one of the reasons you did not locate a manufacturing plant incidentally in Japan, as opposed to Australia, even with Australia's restrictions, I am willing to bet you are going to find as a practical matter it would just not have been cooperated with enough to make it feasible. For many years you were outrightly excluded, whether you realized it or not. That was the law there. I am not saying it did not serve a good purpose. I think when we talk about these issues we ought to put this stuff on the record.

I guess I will conclude with this. You are a good, honest, hardworking man, and your company are good people. I have been impressed with them. You know if I disagreed with you I would flat tell you.

The reason for this bill is not because it is a good panacea or good piece of legislation in a perfect or ideal sense. Douglas Fraser even said that. If you go to do business somewhere around the world, in most places they tell you you have to do this and that if you want to sell cars here. Now, the question is going to become how this country is going to get other people to do things our way, and I guess we are just going to have to hit them over the head a little bit to make them understand when you want to come here and sell a car and do business like you did, you did not have those restrictions. That is going to change unless the rest of the world wants to play in our sandbox and give everybody a fair chance, and that is not the case.

Mr. HUTCHINSON. We are certainly sympathetic to the motivations behind the bill. We are concerned about the people who are out of work. We want those people to go back as soon as possible. We just do not see this bill putting people back to work in Pennsylvania.

Mr. BAILEY. Well, it may not, but in the long run it is going to make some other countries think about their trade and investment policies. That is why the bill is here. No one would have introduced a bill like this 20 years ago.

I thank you very much.

Mr. HUTCHINSON. Thank you, Congressman Bailey.

Chairman GIBBONS. Thank you very much.

This concludes our hearing for this morning and today. We will reconvene next Monday afternoon at 2 p.m. in this room. Among our witnesses will be representatives from the Chamber of Commerce of the United States, the National Association of Manufacturers, the National Foreign Trade Council, and the American Association of Exporters and Importers, and we thank you again.

[Whereupon, at 1:50 p.m., the subcommittee adjourned, to reconvene at 2 p.m., Monday, September 27, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

MONDAY, SEPTEMBER 27, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 2 p.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good afternoon, ladies and gentlemen.

As you know, this is a meeting of the Trade Subcommittee of the Ways and Means Committee. This is on the so-called domestic content bill. I regret we have to have a hearing on a holiday, but the legislation has been referred to us for such a short time and we have so many people who want to testify about this bill that the Chair has to make use of every available moment.

We will proceed to our first witness.

The first witness represents the Emergency Committee on American Trade, Mr. Merlin E. Nelson, the vice chairman of American Machine Foundry, Inc. [AMF]. He is accompanied by Mr. Robert L. McNeill.

Mr. Nelson, you may proceed as you wish.

STATEMENT OF MERLIN E. NELSON, VICE CHAIRMAN, AMERICAN MACHINE FOUNDRY, INC., REPRESENTING EMERGENCY COMMITTEE FOR AMERICAN TRADE

Mr. Nelson. Mr. Chairman, I am pleased to be with you today on behalf of the Emergency Committee for American Trade [ECAT].

I am Merlin E. Nelson, vice chairman, AMF Inc.

Most of the 22 years I have worked for AMF have been in the international sector, including 9 years' residence in London, England, while I was vice president in charge of AMF's international operations.

AMF is a U.S. multinational corporation with sales last year of $1.3 billion. Our business is concentrated in industrial technology and leisure products.

We in ECAT are opposed to enactment of H.R. 5133 for a number of reasons, many of which have been addressed to you by earlier witnesses.

Let me, therefore, more or less simply list the major reasons for our opposition and then go on to more general comments.

I might add here that the automobile manufacturers who are members of ECAT have expressed their views on H.R. 5133 separately to you and through the Motor Vehicle Manufacturers Association.

Enactment of H.R. 5133 would add to domestic inflationary forces at an unpropitious time. Automobiles are already priced beyond the budgets of many prospective consumers. Content legislation would significantly add to these prices and further discourage automobile consumption both through shutting a significant volume of relatively low-priced foreign autos out from the U.S. market and through reducing a competitive spur to more efficient domestic auto production.

The overall consequences of enactment of H.R. 5133 to the U.S. economy would likely be harmful. Studies submitted to the Trade Subcommittee by the Congressional Budget Office and the Congressional Research Service support this.

While new jobs might or might not in the long run be created in the auto sector, it is almost certain that there would be significant job losses in other sectors of the economy—in part because of foreign retaliation against U.S. export industries, and in part also because the rise in car prices will remove purchasing power that otherwise would be spent on other domestic products.

While the extent of such foreign retaliation against U.S. export sales is unknown, I think it certain that retaliatory actions would follow adoption of H.R. 5133. GATT rules authorize GATT members, including the United States, under certain conditions to retaliate against restrictions against their exports, particularly restrictions that are in violation of GATT rules. Enactment of H.R. 5133 would be in such violation, as others have already related to this committee.

What equally concerns me and the other members of ECAT is the indirect adverse consequences to U.S. overseas sales that would follow adoption by the United States of such a major departure from historic U.S. trade policy as domestic content requirements.

For decades the United States has railed against the adoption of domestic content measures by others. Those countries who do utilize the domestic content device tend to be developing countries who are not contributing members of the GATT.

Adoption of the device by the United States would demolish the force of U.S. objections against such foreign performance requirements as domestic content.

Should domestic content requirements be adopted, I think it certain that other countries would mirror this new practice of the United States—and practice we indeed do think it would be since other U.S. industries would seek and perhaps attain the same insulation from foreign competition.

A world comprised of national markets in part reserved by government fiat for domestic producers would be a different and poorer world than the one we now live in.

It would undoubtedly result in a reduction of the volume of world trade since national markets would tend to have higher costs and thus higher prices.

A declining volume of world trade would cause unemployment levels to rise and recessionary forces to become more deeply embedded in national economies.

The 61 members of ECAT rely heavily on their overseas sales and businesses. Worldwide sales and employment of our members in 1981 totaled about $700 billion and 5 million employees respectively.

EACT member companies have plants and other facilities in every State and in all but several congressional districts.

It is not unusual for many of our members to have up to one-half of their revenues from abroad.

These same companies have consistently had a favorable balance of payments as a result of remission of profits exceeding current overseas investment levels.

We thus are representative of U.S. companies who are likely objects of foreign direct retaliation and who are likely to suffer from foreign emulation of any possible U.S. domestic content requirements.

In this respect, I was particularly interested in the testimony addressed to this committee by the Honorable William Dannemeyer on September 23 in which in commenting on H.R. 5133, he stated:

> By what moral authority or legal right do we in Congress derive the power to take jobs away from some Americans and give them to others simply in response to the organized political pressure of a single group?

While strongly opposing H.R. 5133, we are in no way unsympathetic to the condition of the domestic automobile industry. Its plight is serious.

We simply do not believe that domestic content is an appropriate answer. Improved overall domestic economic conditions will provide the appropriate solution, particularly lower interest rates.

Another promising area of action that would substantially improve the market share of domestic automobiles over imported autos would be achieved if the United States would give high priority to alleviating distortions in the yen/dollar exchange rate.

The apparent undervaluation of the yen—some experts estimate that the undervaluation is 25 percent to 45 percent—distorts relative price positions between United States and Japanese goods, thereby artificially worsening the competitive abilities of U.S. producers, worsening the U.S. balance of trade, reducing employment in the United States, and fueling the fires of protectionism.

We urge this committee and the Congress not to legislate H.R. 5133. Its passage would represent a fundamental switch in an historic trade policy that has well served the American people.

Protecting the American market is not an adequate answer to our economic problems. Revitalization will be better achieved through becoming more competitive both in our home and overseas markets.

We cannot become more competitive in the world while at the same time becoming less efficient in a governmentally protected domestic market.

The American people want less government regulation. The kind offered in H.R. 5133 is of the worst kind.

When we last testified before this committee, we urged enforcement of U.S. rights under the GATT and implementing domestic statutes as the appropriate response to current trade problems.

We reiterate that here, and urge the Trade Subcommittee to approve the reciprocity bill pending before you. That will enhance the U.S. ability to respond to unfair trade practices and will better enable the President to negotiate improvements in the GATT structure so that the problems besetting foreign direct investment and international trade in services can be accommodated.

I might add that one of those major problems is the proliferation among the less developed countries of domestic content and other performance requirements.

Thank you for your attention.

Chairman GIBBONS. Thank you, Mr. Nelson.

There is very little in your statement I would take issue with at all. I think it is a fine statement.

Let me ask you some questions about the Japanese yen. I do not know whether you are an expert on the yen or not, but this gives me an opportunity to get off my chest some of the things I learned over the weekend about the Japanese yen.

One of the obvious problems with the yen may be this bill. This bill will have an adverse effect upon international trade, particularly upon Japan's trade, land that is reflected in the yen.

The second thing is, if the Japanese are doing anything about the yen, they are trying to prop it up.

The third thing I learned was from this morning's Wall Street Journal. That is, there is a financial crisis in Japan caused by a number of things, namely, a dropoff in their trade.

They have some real problems apparently

I do not try to keep up with what is going on in Japan, but apparently there is a problem in their economy with high deficits and a sluggish economy.

I read the Federal Reserve's report that we received Friday afternoon concerning the international currency markets. It seemed to reiterate the same thing I have been telling you here. If there is any manipulation going on or undervaluing of the yen, it is mainly as a result of the market forces, according to the report.

I do not know whether you have had a chance to look at that report, or whether you ever do or not. I realize not many people do, but I was disturbed because Mr. Caldwell mentioned the yen undervaluation as being a problem; obviously it is a problem.

I am afraid maybe what we are doing here—all the things we have done—have had its impact upon Japan, but that impact has not necessarily been to the advantage of our motor manufacturers.

The more we debate this legislation, the more the people in the money market will say: " That Japanese yen isn't where I want to leave my money, my reserves," and they will move out of yen and into dollars.

I just wonder if you have anything to say about that?

Mr. NELSON. Well, I am not an expert on the Japanese yen. Therefore, with that qualification, I would comment the way I see it.

I think one of the things that should be borne in mind is that there are considerable restrictions that exist today in the financial markets of Japan.

Japan has resisted, for example, letting the yen become a reserve currency. If these financial restrictions were lifted, there would be more purchasing of the yen. Obviously, the yen price would then go up instead of going down.

So there are some things, it seems to me, that can be done here. If Japan were really an open market, that would result in a stronger yen, wholly apart from their own domestic problems which I read about too. That is one point.

I think the other, the more important point, than the undervaluation of the yen, is the reciprocity side of it.

The dollar is overvalued. The overvalued dollar is something we can do something about. There I think the remedies—The fault, dear Brutus, lies not in our stars, but in ourselves.

We have to do something about that problem. The problem has been much discussed. I need not go into it. I think the solution will require legislation that will address the transfer payments issue, and will also require a slowdown in the rate of increase in defense spending. The result will be a balanced or getting closer to, a balanced budget, thereby easing the pressure on the financial markets; thereby resulting in reduced interest rates; thereby resulting in a lower dollar value, and, therefore, the relationship between the dollar and yen would tend to be corrected with that.

Those are things we can do something about. That is more of a long-term solution.

It is a more permanent one and one that would move in the direction of supporting our trade. AMF is no different than any other company today in that we are having a hard time continuing growth in our exports the way we have in recent years in the face of the strong dollar.

Chairman **Gibbons**. The overvalued dollar worries me. The strong dollar, of course, make me feel proud of America. I am sure you feel that way, too.

I obviously do not know all the answers to the floating currency problems. I am not sure that anybody does, but when I look at what is happening in Europe, you have a debacle going on over there, severe economic problems in France right now, so the dollar will obviously increase against the franc.

Germany has been having political problems. Maybe they got solved in yesterday's elections. The British have not been doing too well for 25 years. So their currency slips.

Canada is trying to make a country out of something that is 100 miles wide and 3,000 miles long, and, in my opinion, doing all the wrong things in their economic picture.

They tried to run out U.S. capital and we have tried to sort of go it alone. Thus, their currency is going down.

Mexico's currency is obviously going down because of all the problems they have. Brazil just went on the skids over the weekend. You know, as bad as it is here in this country, I do not see anything happening to our currency except going up. At least foreign money is safer here. I am not sure we will see any relief on this front for a long time.

Mr. **Nelson**. I would just add that sustained high U.S. interest rates obviously put foreign governments on the defensive because they have to protect their currencies against them. It forces their interest rates up. The result of that is that you have a deceleration of the economies.

So, in effect, our high interest rates over a protracted period of time have slowed down the economies of the world and have, in some ways, been contributing to these problems that you described.

It isn't as if we can do things in isolation. We are too dominant a force in the world.

Chairman **Gibbons**. I agree.

Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman.

Now that you have both agreed the problems aren't insoluble, can we decide to what extent they are?

You indicate, Mr. Nelson, that we should pass the reciprocity bill that is now pending before us to strengthen the hand of the President and his trade representative in GATT and in international negotiations.

The chairman and I would dearly love to do that. Apparently we have our hands full here.

Chairman **Gibbons**. It is defeating to move too fast around here. We have some people who vote with their feet.

Mr. **Frenzel**. In any case, any problem we have with reciprocity is exacerbated by an unwillingness of a number of the interest groups around here to support the extension of the 124 bargaining authority which now threatens to go along with reciprocity. Does your group have a position on whether 124 should be included with the reciprocity bill?

Mr. **Nelson**. We have supported the inclusion of 124. Bob McNeill said we recently sent a telegram to members of the Ways and Means Committee to that effect.

Mr. **Frenzel**. I would like to go to the yen/dollar rate too. My experience has been the same as that of the chairman. Every time we look into it, we have great difficulty in accumulating any hard evidence that says somebody is putting magic in the game.

I guess if one looks at the fiscal conditions in Japan, this is the fourth year of pretty substantial deficits, higher proportionally than ours.

You have, particularly in the last couple of quarters, some down quarters. You have most of the things that they buy denominated in dollars already, so the high dollar hurts them before they even get the stuff aboard. I guess I am not wholly persuaded that that is not a market rate we are talking about.

Could you straighten me out on that?

Mr. **Nelson**. I am not sure. I spent a fair amount of time in Japan. I have a son living and working there. Therefore, I think I have had enough exposure to Japan to know that I do not know a great deal about it.

I think the more time you spend there, the less you know.

One thing though, the Japanese deficit is substantially higher as a percentage of GNP than that of the United States. What is particularly relevant is how they fund that.

Their savings rate is one example. The Japanese do a lot of interesting things that perhaps we could consider doing. For example, we have our all-savers certificate—that kind of thing. The Japanese have, if I recall correctly, a system whereby every person in Japan can, in effect, put $1,000, or depending upon the exchange rate, perhaps more than that, into government savings at what is, I think, about a 7- or 8-percent tax free rate.

They do not really look very hard at how many names go down there. The result is there is an enormous amount of money that is saved in Japan because there is an incentive to do so. Therefore, the pressure on their financial markets is much less than on ours. They have ways of generating much larger savings in order to finance those deficits.

So I am not sure we gain a great deal by sort of probing in depth into what it is that makes the Japanese economy tick, and whether they are really doing some things that are preventing the yen/from achieving its true level of value, whatever that may be.

I think the thing we should do is continue to place pressure on the Japanese to open up their markets, including their financial markets. I think in doing so, if there is some subsidization of that yen, that would tend to disappear.

As long as they have a protected situation, then you are likely to have something that might be called an undervalued yen.

I do not think that the yen/dollar exchange relationship should be focused on as kind of the main problem confronting the United States. We are not just exporting to Japan. We are exporting throughout the world. We are very much bothered by an overvalued dollar. I agree with your point, Mr. Chairman, about a strong dollar. We are not worrying about that.

The overvalued dollar is a direct consequence of the protracted high interest rates drawing in investment—short-term investments—from world sources.

Mr. FRENZEL. I thank you.

What about the yen being made at least some sort of auxiliary reserve currency?

Mr. NELSON. I would think that that should be done. Japanese trade represents such a substantial part of world trade today that it is high time for Japan to begin to share in that burden. That is the burden that we have, whether we like it or not, on the dollar.

Mr. FRENZEL. Getting back to domestic content, has your committee made any overall analysis or is it presenting the views, accumulation of the views of its members?

Mr. NELSON. We have not. We have relied on the analyses that have been done by others, with which you are very familiar.

Mr. FRENZEL. It is your statement, or that of your organization, that more will be lost than could conceivably be gained?

Mr. NELSON. Absolutely.

Mr. FRENZEL. Thank you very much, Mr. Nelson.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Mr. Nelson, on the second page of your statement, down at the bottom, you say:

> What equally concerns me and the other members of ECAT is the indirect adverse consequences to U.S. overseas sales that would follow adoption by the United

States of such a major departure from historic U.S. trade policy as domestic content requirements. For decades the United States has railed against the adoption of domestic content measures by others.

What alternatives would you suggest? During these hearings I have tried to do my best to bring a perspective to domestic content that is a little different than you would gain from simply looking at the legislation on its face.

On its face, it is not a good idea. But viewed in context, I am one of the cosponsors. I am someone who has worked very hard for it. I view it as a vehicle to carry some other information out there. Taking those two things in your statement, from historic U.S. trade policy, and the United States has railed against the adoption of domestic content, how successful have we been? Douglas Fraser spoke here; Mr. Caldwell spoke here, the chairman of the board of Ford Motor Co. Both made impressive statements. They dispelled a lot of the myths or addressed some of the criticisms about American labor, management, ideas, the capital costs of conversion, variables beyond our control that led to the crisis in the automobile industry, and so forth.

What it all boils down to is people are listening and paying attention and responding to this as a policy choice, albeit a very inefficient, some say dangerous—I don't think so—but potentially harmful one. I think that is possible.

People do not know what to do. I have stated many times if I could beg the Japanese to realize what kind of reaction they are causing worldwide, they are being viewed the wrong way.

People feel victimized; countries feel used; they feel business is not being done in a fair way when you deal with Japanese companies. Every time you talk about what you are up against, you are usually up against some mixture of security that a Japanese company can bring to a bargaining table, and a contract negotiation that some other company can't because they have better government backing and that kind of thing.

If you talk to Europeans, they feel victimized or used. If you talk to Third World country diplomats and businessmen, they feel used. If you talk to American businessmen, they feel used.

I don't mind accepting a competitive challenge at all. I have too much pride in this country to say that it is just—if we can do things that way, let's do them, or if you want to get in competition between nations and see who can drive who into the sea, those kinds of childish and silly, prideful kinds of things, if we have to do that I guess we could fight as well as anybody else.

Given your thesis or given the assumption that this is not the best thing to do by far, what would you suggest doing, or am I wrong? Things creep into your statements.

In your answer to the chairman there is a little edge about what you say about doing business with Japan or in Japan. There is an edge in your voice. You use the word "open." It crept into your response to the chairman's question about currency.

What do you do? Plead with the Japanese? Historic U.S. trade policy, what has happened?

Haven't we been able to get much response out of them? We have railed against the adoption of domestic content measures by others, yet no matter what you do in Japan, it seems you are always up against the wall.

What do you do? How do you make the executive branch listen? How do you make the Japanese Government, Japanese industry listen? What do you do?

Mr. NELSON. Well, let me try to answer your questions and your concerns.

I guess we start off by saying that if we have a problem—and we do—it is probably not a good idea in our frustration to shoot ourselves in the foot. This legislation, if adopted, might result in perhaps even some more important member of the human anatomy being injured as a result.

It seems to me that it gets back to temperament and approach to these problems. We in America are an impatient people. We want things to be done immediately. I speak from a fair amount of experience negotiating with the Japanese, including one negotiation that went on for about 7 weeks, which ended up in a successful joint venture AMF had in Japan for 15 years, probably one of the most successful that has been done in history.

We have to have patience, first of all.

Second, we have to have perseverance.

The third thing we have to do is, we have to be very, very tough.

Mr. BAILEY. Have we been any of those things?

Mr. NELSON. I am not sure. I am not intimately involved in those negotiations.

I will say this: You should not plead with the Japanese. You have to negotiate with them. They are hard bargainers.

Mr. BAILEY. Everyone tells us the same thing but you used the word "historic" U.S. trade policy—how successful have we been? You can bet your particular part of the human anatomy that there is going to be a heck of an economic reaction if we do not do something. That is all this legislation is.

Mr. NELSON. I think you are looking at one point in time here, Congressman Bailey. If you go back over the history of the development of world trade and the prosperity of this country and other countries in the post-war era, it is directly related to the fact that world trade moved very much in the direction of free trade.

Now we have the problem with the Japanese. I think this too will pass, but you better be patient and persevere and not depart from your basic philosophy.

What we should be doing is pressing the Japanese more effectively to open up their markets and, as I said before, we should be addressing some of the problems we have ourselves that have exacerbated the situation.

Mr. BAILEY. How do we get them to do it?

Mr. NELSON. I am sorry?

I missed your last question.

Mr. BAILEY. I said, how would you get them to do it?

Mr. NELSON. I think the reciprocity legislation is one way to do it. There are probably even more effective ways. You have to sit down and do an inventory of what the assets are on your side; what you have got by way of negotiating strengths, and then sit down and negotiate with them.

Mr. BAILEY. What do we have as negotiating strengths?

Mr. **Nelson**. I would stress one thing, though. I think focusing on the Japanese will not solve our problems.

Mr. **Bailey**. I agree very much with that. What are our major problems?

Mr. **Nelson**. I think we go back to the problem we discussed earlier. I think you have to get the economy on a better basis here so we do have low interest rates and have a vibrant economy. Therefore, we can export. We can export in substantial quantities. That low interest rate and resultant lower exchange rate is going to result in the Japanese having to make the very same decision, Congressman Bailey, that we had to make in many countries overseas. We had to invest in those countries because it was the only way we saw that we could penetrate their markets.

I would stress when we did do that investing, almost always it was what I call the peripheral or supplemental type of investment where the basic export from the United States was still our aim.

Mr. **Bailey**. Let me tell you what I think in a nutshell. I think the things we did following the Second World War were the proper and right thing to do. I think we had to get the world basically back on its feet. I think we came out of that war the big, strong, brawny country that I think in many ways we still are. I think we realize if there is going to be any security in the world order, if there was going to be a continuation of the political values we held dear we had to transfer a significant amount of capital, technology, and stability worldwide in order to make sure that that order was successful.

I think some of the nations that we put back on their feet—I think Japan is one of them—and I am not going to the issue of who was right or wrong in terms of the Second World War, and I am not going to the issue of whose side prevailed—the point is we have an awful lot in common today. I think that that world order is being threatened, but ironically it is being threatened by countries that we protected in sort of a reverse kind of way, if you know what I mean.

Maybe we were responsible for starting practices that enabled them to get on their feet and maybe those practices have continued and become a way of doing business. I don't know. But I know the time has come for them to grow up because their standard of living has arrived. I know we have a stake in the defense of the free world and they are not—there are a good many reasons for this, not all, incidentally, their fault; it is a very difficult problem, accepting defense burden.

I think in that whole process the problem you have is the American public. I think they are fed up. I think there is some justification for that. There is the American self-view of being the good old Uncle Sam, best intentioned country that we view ourselves to be. We have this certain degree of political and moral self-righteousness which, quite frankly, I think we are entitled to, because, frankly, I share it.

I will just finish up by saying I have had a couple of examples of dealing with the Japanese on behalf of companies. It has been the Japanese I have had the problem with in my district. One was a case where a contract was completely rewritten by the Taiwanese to allow the Japanese to bid on an industrial rate switch of an amperage level that they did not even make, but because they were able to go to their government and get a guarantee of a long-term financing cost, the American company was eventually turned down on the contract, although they were the low bidder worldwide by far for the particular switch involved. That was one case.

That is personal. That is my own phone calls to the Taiwanese, to these companies, even contacting or complaining to the Japanese. You just cannot do business that way. You build up resentment.

Mr. **Nelson**. Let me give you a specific example. Maybe this will make us a little more optismistic. In 1961, I went to Japan on an open ticket to negotiate a joint venture which turned out to be with C. Itok, one of the largest trading companies in Japan, to make them our partner to develop the market for bowling in Japan.

That was a tough negotiation. I was negotiating with three other potential partners at the same time. Six or seven weeks later we ended up with the outline of an agreement which we then formalized later that year. The joint venture no longer exists because we completely saturated the Japanese market with bowling equipment. The results of the joint venture, which was an entirely friendly partnership, not without its disagreements and so on in the course of its 15 or 16 years of life, was over $600 million of sales and over $100 million of pretax profit. The important point here is that we retained the right to produce those pinspotters outside of Japan, not in Japan—those are the machines that automatically reset the pins—and if and when we had to produce them at some point in Japan, we retained the right to have it done through our wholly owned subsidiary in Japan and not through the joint venture.

So the joint venture never ended up producing those machines. Enormous amounts of exports went from the United States to Japan. It can be done. Those are the same Japanese we are railing against now.

Mr. **Bailey**. Is that what you called spotting machines for bowling alleys? Was it a high technology item?

Mr. **Nelson**. I guess so. There are only two companies in the world that produce them today.

Mr. **Bailey**. That doesn't make them high technology.

Mr. **Nelson**. I would say it is reasonably high technology.

Mr. **Bailey**. Are they on any kind of target?

Mr. **Nelson**. The Japanese did end up producing a system of their own. But we still dominated the Japanese market.

Mr. **Bailey**. I think——

Mr. **Nelson**. All——

Mr. **Bailey**. I think you know your example is not shared by a lot of other industries, particularly in certain areas.

Mr. **Nelson**. What I am saying, though, Congressman Bailey, is don't close the doors. Give us a chance to get the doors more open. Then American industry ought to go in and do the job.

Mr. **Bailey**. I agree with you. I will finish up with this. I went to a meeting when this was going on. Let me tell you what ended up being the straw to break the camel's back. Our chairman set up a meeting with a bunch of Japanese parliamentarians. I went to the meeting in the hopes that we could voice some complaints and that type of thing. I was not of the generation that fought the Japanese. I don't have anything bad to say about the country. I view them as a fantastic people. I guess as a politician or a believer in democracy, I covet every democracy in the world like it is a precious gem in this modern world given the desire we have to avoid nuclear war and still maintain a democratic life.

I thought the treatment we got, as hosts in terms of the way the dialog went, was absurd. I will put that on the public record. I think it was rude, discourteous, and absurd. It was little more than a bunch of wishy-washy, shilly-shallying, nothing talk, and there were at least two other members that shared my opinion on this, by the way.

I didn't initiate the conversation concerning the way they just talked and talked and said nothing. So obviously doing that in a deliberate way. I resented it. I dismissed a lot of it, I guess, because I thought, geez, maybe they don't understand the system. Maybe everybody thinks in this system all you have to do is go to the executive branch and talk about trade. The whole public is awake now. The press is awake. The public is awake. American opinion is awake. Trade policy will never be written that way again. It will never be written that way again.

I think the executive branch ought to get smart and realize it. I think Congress doesn't have any choice because it is a responsive institution by its nature. I think most of all the Japanese have got to realize that. They have just got to realize it. With the exception of some practices in Europe where there is too much subsidization going on, the biggest justification for a piece of legislation like this is going to be a very well justified complaint about how this country has been treated in trade matters.

It is a lousy, poor response, as you said, but to go back to a hackneyed cliche very much in use today, it is one of the few if not the only game in town. They better listen or there is going to be a reaction that will be hard to control for many years.

I have to come down on the practical side, I guess, and say write a lousy piece of legislation that will not take effect for a couple of years. It is not going to change anything overnight. Somebody will listen.

Mr. NELSON. I understand the critical pressures. It is a political response. I think one of the things that most businessmen tend to deplore is a lack of realization in this country of the importance of trade to the continued vitality of the economy of the Nation, and that must take precedence over anything else. Trade ought to be off limits, not some sort of political football that can be kicked around whether by a Republican or Democrat.

Mr. BAILEY. You are right, but it is not a partisan issue anyway, for crying out loud. I think what you ought to do is sell what you just said to your Japanese friends. They have got to do something with that mentality. The Europeans have to stop talking about the steel industry or we will have to do some protecting. Our workers, our public have a right to those kinds of things, too, particularly when we find our relative economic strength declining—relative.

Chairman GIBBONS. Thank you, sir.

Next we will have panel No. 1, the American Association of Exporters & Importers, Mr. Greenbaum; National Foreign Trade Council, Mr. Roberts.

STATEMENT OF LEE A. GREENBAUM, PRESIDENT, KEMP & BEATLEY, AND PRESIDENT, AMERICAN ASSOCIATION OF EXPORTERS & IMPORTERS, ACCOMPANIED BY EUGENE MILOSH, EXECUTIVE VICE PRESIDENT, AND BARRY NEMMERS, STAFF ATTORNEY

Mr. Greenbaum. Mr. Chairman, members of the subcommittee, I am Lee Greenbaum, president of Kemp & Beatley, and president of the American Association of Exporters & Importers. I am accompanied by Eugene Milosh, on my immediate left, our executive vice president, and Barry Nemmers, our staff attorney.

AAEI, formerly the American Importers Association, represents 1,400 U.S. company members engaged in the export, import, and distribution of goods between the United States and countries throughout the world.

The association broadened its purpose last year in response to a general shift of many members into exporting, and to the widespread and deeply felt belief among the members that it was no longer realistic to focus solely on the concerns of importers. It was realized that the policy of the United States toward imports must inevitably be tied in with the health of the international trading system and the ability of American businesses to function successfully in the global marketplace. Increasingly, AAEI members have found, American firms do not function solely as importers or as exporters, but as buyers and sellers in a global marketplace, where the origin and destination of goods is less important than the ability of our companies to compete effectively and on equal terms with other companies operating in the same marketplace.

It is for precisely these same reasons that we find H.R. 5133 to be a dangerous and misconceived bill. No longer can the United States afford to consider the imposition of import restrictions in isolation—ignoring the effects such restrictions will have on a multitude of U.S. domestic and international interests.

The specific arguments against this bill have been expressed in some detail in a number of studies and by other witnesses before this committee. We need to restate them only briefly:

The implementation of domestic content requirements on imported automobiles would reverse the trade policies of the United States since World War II. A keystone of these policies has been reciprocal market access. This Nation has pressed for reciprocal treatment by urging other nations to reduce trade barriers and to open their markets. H.R. 5133, however, would place this Nation in the awkward position of having effectively closed a major market. The damage done to our credibility as a nation committed to open trade would take decades to repair.

The provisions of this bill clearly violate articles III and XI of the General Agreement on Tariffs and Trade which specifically prohibit domestic content requirements. By violating the GATT, the United States would subject itself to retaliation from affected trading partners. The areas in which our trade is most competitive will be placed at risk. U.S. farmers, aircraft manufacturers, and producers of high-technology goods, among others, can ill-afford drastic reductions in their markets. Certainly, the United States cannot risk such injury to its domestic economy.

The world trading system is witnessing a dramatic increase in the imposition of domestic content requirements, particularly by the less developed trading nations. The United States has strongly objected to these non-tariff barriers.

These extremely high costs to the domestic economy and to non-automotive trade sectors would be paid without assurance that the U.S. automobile industry and its work force would be equally benefited. Several studies have even indicated a potential net loss of jobs in the overall U.S. work force.

H.R. 5133 is virtually certain to damage the U.S. economy and raise costs to the consumer far out of proportion to the economic gains resulting from the rehiring of even 200,000 autoworkers.

This domestic content bill is a negative solution. The United States should provide an economic and regulatory environment which facilitates the industry's current efforts to increase productivity and quality while maintaining competitive prices. Government solutions which damage the international economy will only impede the industry, while U.S. efforts to stimulate the international economy will aid the industry's efforts and benefit all U.S. citizens.

Finally, in its escape clause investigation of the automobile industry, the International Trade Commission found that imported automobiles were not a substantial cause of the domestic industry's difficulties. Thus, attempts to curb the trade in imported automobiles is unlikely to resolve the problem. Rather, we believe, by aggravating overall economic conditions, such restrictions are more likely to compound the industry's reduced sales.

Enactment would not just invite others to engage in a trade war, it would also stand as a rejection of the discipline which is the underpinning of that system. It has been U.S. policy to exercise that self-discipline and to persuade by example. As a Nation we have kept our markets open and have abided by the rules and purposes of the GATT. We have believed that as the largest trader in the world we could do more for ourselves in the long run by promoting that system and resisting temptations to violate its rules for short-term benefits. We must continue to follow that course. The policy reversal contained in this bill would damage that system to perhaps an irreparable degree.

This committee has a tradition of making difficult decisions in the long-range interests of the Nation. AAEI urges it to do so again by rejecting H.R. 5133.

Thank you for the opportunity to testify today. We would be pleased to answer any questions you may have.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS

Mr. Chariman and members of the subcommittee, the American Association of Exporters and Importers, formerly the American Importers Association, represents 1,400 U.S. company-members engaged in the export, import, and distribution of goods between the United States and countries throughout the world. The multitude of products sold by AAEI member companies cover a broad range from textiles and apparel, chemicals, machinery, electronics, footwear and food to automobiles, wines and speciality items. In addition, many organizations serving the trade community—custom brokers, freight forwarders, banks, attorneys and insurance firms—are active members of AAEI.

The Association broadened its purpose last year in response to a general shift of many members into exporting, and to the widespread and deeply felt belief among the members that it was no longer realistic to focus solely on the concerns of importers. It was realized that the policy of the United States toward imports must inevitably be tied in with the health of the international trading system and the ability of American businesses to function successfully in the global marketplace. Increasingly, AAEI members have found, American firms do not function solely as importers or as exporters, but as buyers and sellers in a global marketplace, where the origin and destination of goods is less important than the ability of our companies to compete effectively and on equal terms with other companies operating in the same marketplace.

It is for precisely these same reasons that we find H.R. 5133 to be a dangerous and misconceived bill. No longer can the United States afford to consider the imposition of import restrictions in isolation—ignoring the effects such restrictions will have on a multitude of U.S. domestic and international interests.

It is most appropriate that you have invited testimony on the effects of H.R. 5133 on U.S. interests beyond the automotive sector.

The specific arguments against this bill have been expressed in some detail in a number of studies and by other witnesses before this Committee. We need to restate them only briefly:

1. The implementation of domestic content requirements on imported automobiles would reverse the international trade policies adopted by the United States since World War II. A keystone of these policies has been reciprocal market access--an issue of concern to this Congress, the Administration, and the trade community. This nation has pressed for reciprocal treatment by urging other nations to reduce trade barriers and to open their markets. H.R. 5133, however, would place this nation in the awkward position of having effectively closed a major market. While this regressive act perhaps might be removed at some future date, the damage done to our credibility as a nation committed to open would trade would take decades to repair. Enactment of such a drastic change in U.S. trade policy would clearly signal to our trading partners that the United States no longer considers itself bound by GATT rules.

2. The provisions of this bill clearly violate Articles III and XI of the General Agreement of Tariffs and Trade which specifically prohibit domestic content requirements. Reductions in the severity of specific provisions of the bill will not remove it from the GATT's proscription.

3. By violating the GATT, the United States would subject itself to retaliation from affected trading partners. Certainly, they will not seek compensation from inconsequential trade sectors. The areas in which our trade is most competitive will be placed at risk. Estimates of the amount of U.S. exports vulnerable to retaliation have exceeded $15 billion. U.S. farmers, aircraft manufacturers, and producers of high-technology goods, among others, can ill-afford drastic reductions in their markets. Certainly, the United States can not risk such injury to its domestic economy.

4. The world trading system is witnessing a dramatic increase in the imposition of domestic content requirements, particularly by less developed trading nations. The United States has strongly objected to these non-tariff barriers because of their effect on U.S. exports. Enactment of H.R. 5133 would nullify our attempts to seek their removal and—just as the bill seeks to keep foreign automobile exports out of the U.S. market—would result in the loss of foreign markets to U.S. exports.

5. These extremely high costs to the domestic economy and to non-automotive trade sectors would be paid without any assurance that the U.S. automobile industry and its workforce would be equally benefitted. The only certain conclusion which can be drawn from the many studies done on the potential overall employment effects of H.R. 5133 is that we cannot expect wholesale rehiring of the unemployed automobile work force. Several studies have even indicated a potential net loss of jobs in the overall U.S. workforce. No government study agrees with overstated predictions of the bill's proponents.

6. H.R. 5133 is virtually certain to damage the U.S. economy and raise costs to the consumer far out of proportion to the economic gains resulting from the rehiring of even 200,000 autoworkers. What will this nation have gained if increased employment in one labor sector is met by lost jobs in other sectors, serious increase in in-

flation, and decreases in world market access for agriculture and vital growth industries?

7. The U.S. automobile industry and its workforce should be assisted in a positive way. This domestic content bill is a negative solution. The United States should provide an economic and regulatory environment which facilitates the industry's current efforts to increase productivity and quality while maintaining competitive prices. We are not discussing an antiquated and moribund industry, but rather a dynamic group of companies with the potential for regaining the highest levels of international competitiveness. Government solutions which damage the international economy will only impede the industry, while U.S. efforts to stimulate the international economy will aid the industry's efforts and benefit all U.S. citizens.

8. Finally, in its escape clause investigation of the automobile industry, the International Trade Commission found that imported automobiles were not a substantial cause of the domestic industry's difficulties. Thus, attempts to curb the trade in imported automobiles is ill-focused and unlikely to resolve the problem. Rather, we believe, by aggravating overall economic conditions, such restrictions are more likely to compound the industy's reduced sales.

Despite the seriousness of the effects just described, AAEI is even more concerned about the more subtle damage the bill would do to the world trading system—a system this country has promoted and carefully nurtured for over thirty years. Enactment would not just invite others to engage in a trade war, it would also stand as a rejection of the discipline which is the underpinning of that system. It has been the United States policy to exercise that self-discipline and to persuade by example. As a nation we have kept our markets open and have abided by the rules and purposes of the GATT. We have believed that as the largest trader in the world we could do more for ourselves in the long run by promoting that system and resisting temptations to violate its rules for short term benefits. We must continue to follow that course. The policy reversal contained in this bill would damage that system to perhaps an irreparable degree.

It is extremely difficult to say not to a large number of unemployed Americans. This Committee, however, has a tradition of making difficult decisions in the long-range interests of the nation. AAEI urges it to do so again by rejecting H.R. 5133.

Thank you for the opportunity to testify today. We would be pleased to answer any questions you may have.

Chairman GIBBONS. Thank you, Mr. Greenbaum, for your fine testimony.

Our next witness is Mr. Roberts.

STATEMENT OF RICHARD W. ROBERTS, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, ACCOMPANIED BY PAUL MURPHY, VICE PRESIDENT, GOVERNMENT ACTIVITIES

Mr. ROBERTS. Mr. Chairman, I am Richard Roberts, president of the National Foreign Trade Council. With me is Paul Murphy, an NFTC vice president.

These remarks are a boiled down version of the written testimony which has been submitted.

Chairman GIBBONS. Your full testimony and the testimony of all other witnesses will be placed in the record as if delivered in full.

Mr. ROBERTS. Our membership which consists of companies having substantial exports and investments abroad is concerned about the effect H.R. 5133 would have on our trade relations with other countries; in particular, the effect the bill would have on American exports. We share with proponents of the bill a desire for a healthier auto industry and an expansion of auto industry jobs, but we do not believe insulating the industry from foreign competition is the solution.

Indeed, the predictable result of passing this legislation would be not only to curtail the recovery of the U.S. auto industry but to damage the American economy as a whole. A basic premise of proposals such as this bill which would insulate segments of the U.S.

economy from world competition in the United States is a self-contained economic unit of such power and diversity that it can at will unilaterally reduce trade with other nations to achieve domestic economic objectives. A corollary to that proposition is that other nations will be forced to accept these American initiatives because they lack the will or ability to take countermeasures.

This premise of an economic "fortress America" is unrealistic and dangerous. Our major trading partners purchase over $200 billion worth of U.S. goods and services annually, but with rare exceptions, they are under no compulsion to do so. Substitute products and services are generally available on the world market. The economies of the main trading nations to which we export are currently afflicted by exceptionally high unemployment and slow growth which has placed increasing pressures on their governments to intervene to protect domestic industries.

Thus, our major trading partners have both the power to decrease the volume of U.S. exports in retaliation for protectionist actions by the United States and, in many cases, the will to do so.

Second, the United States has for over 30 years been committed to supporting the free and open international trading system. Our country was one of the architects of the GATT in 1945. More recently, in the Tokyo Round of multilateral trade negotiations, with the full support of Congress, the United States reaffirmed its commitment to the GATT and to reductions of governmental interventions in trade and to the preservation of open markets.

The substantial foreclosure of a major sector of the U.S. economy, automotive products, from international competition would violate clear and specific commitments made under the GATT and would contribute to a weakening of the international trading system which has sustained the growth of world trade for decades.

Let me now address briefly and more specifically the consequences of H.R. 5133 for trade relations with other nations. A fundamental problem of H.R. 5133 is that it directly violates the GATT rules. If H.R. 5133 is enacted we can expect one or more injured countries to file a formal complaint in the GATT seeking compensation from the United States. We think it is virtually certain the United States local content law would be found to breach GATT rules and the injured party would be authorized by the GATT to institute restrictions on designated imports from the United States.

Alternatively, an injured country might elect to take more direct action either by buying less U.S. products and purchasing the balance elsewhere or by imposing tariffs or quotas on U.S. goods even without GATT sanction or by establishing nontariff barriers to the entry of U.S. products. Among leading products identified by the Administration which might be subject to retaliatory action are aircraft, office equipment, electrical components, corn, wheat, and soybeans.

Whatever the form of retaliation, the result will be a loss of U.S. exports and export-related U.S. jobs. It is virtually certain this loss would be at least as great as any hypothetical gain, and probably much greater than any gain H.R. 5133 might bring about. We are also concerned that the adoption of a local content law in the United States will encourage similar restrictions abroad. Local content and buy national practices overseas are already a pervasive impediment to U.S. exports. We cannot afford to encourage them. Should the United States file a complaint in the GATT against retaliatory buy national laws or practices of other nations, it is unlikely relief would be granted as long as the United States itself remains in violation of GATT rules.

H.R. 5133 would also directly undercut current administration efforts to encourage trade liberalization measures by other nations. At the GATT ministerial meeting in November, for example, the United States will seek a liberalized world trade in agricultural commodities, in the services industry, and in high technology. The imposition by the United States of a barrier to international trade in automobiles will undermine our negotiating position in that forum as well as in ongoing trade discussions with Japan, Canada, and the EC, defeating United States efforts to obtain reductions in other nations' trade barriers.

We are also concerned that the adoption of H.R. 5133 will lead to pressures on Congress for more Federal-local content laws applicable to other import vulnerable American industries. If these laws proliferate, reduced competition, higher prices, and more trade conflicts with foreign nations will surely follow, leading to higher levels of retaliation and ultimately trade stagnation.

In addition, the adoption of a Federal-local content bill will lead to increased pressures on State legislatures to adopt buy American statutes of their own which will have similar adverse effects on prices, competition, and exports.

To sum up, enactment of H.R. 5133 would encourage protectionist forces everywhere and open the way to a surge of trade restrictions and loss of employment throughout the world, not least in our own country. In its most recent annual economic review, just released, the GATT has warned that the world economy is in its worst state since the 1930's and that protectionism poses a growing danger to growth of trade. That danger would be magnified by the adoption of protectionist legislation in the United States.

We therefore strongly urge that Congress defeat H.R. 5133.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF RICHARD W. ROBERTS, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL

The National Foreign Trade Council is an association of over 600 U.S. companies engaged in foreign trade and investments. Our membership, which represents more than half of U.S. exports of manufactured goods and services, is deeply concerned with the adverse effects which H.R. 5133, the "Fair Practices in Automotive Employment Act," would have on trade between the United States and foreign countries.

While we share with proponents of the bill a desire for a healthier auto industry and a sharp expanion in auto industry jobs, we believe that insulating the industry from foreign competition will not achieve these objectives; indeed, the consequences of this protectionist legislation will be to damage the American economy and the auto industry in these ways:

Overall, employment gains in the auto industry will be offset by job losses in other sectors of the economy;

The American auto industry will be unable to utilize the lowest cost source of supply, thereby placing it at a competitive disadvantage in the international marketplace; and

The American economy as a whole will suffer, not only because of the inflationary impact of higher auto prices, but even more importantly because domestic content legislation will severely damage trade relations with our principal trading partners, trigger retaliation against U.S. exports and encourage similar "buy national" strategies which will bring about a reduction in U.S. exports.

Studies by Federal agencies and private organizations have documented the effect of the bill on the cost of automobiles and on employment, both in the automotive manufacturing and automotive import sectors. My purpose here is to focus on the effect which the bill will have on our trade with other nations.

A basic premise of proposals to insulate segments of the U.S. economy from world competition is that the United States is a self-contained economic unit of such power and diversity that it can, at will, unilaterally reduce trade with other nations to achieve domestic economic objectives, without significant costs to our own country. A corollary is that other nations will simply be forced to accept these American initatives because they lack the will or the ability to take counter measures.

This premise, of an economic "fortress America," is both unrealistic and dangerous today for two reasons. First, the United States is a part of an interdependent world economy. Our major trading partners purchase billions of dollars in U.S. goods and services, but with rare exceptions they are under no compulsion to do so; substitute products and services are generally available on the world market. Moreover, the economies of most of our major trading partners are afflicted by exceptionally high unemployment and slow growth, which has placed increasing pressures on governments to intervene to protect domestic industries. Thus our major trading partners have both the power to impose effective sanctions against U.S. exports in retaliation for protectionist actions by the United States, and in many cases strong political and economic incentives to do so.

Second, the United States has for over 30 years been a leader among nations in supporting a free and open international trading system. Our country was one of the architects of the GATT in 1945. More recently in the Tokyo Round of multilateral trade negotiations, with the full support of Congress, the United States reaffirmed its commitment to the reduction of governmental intervention in trade and to the preservation of open markets. The substantial foreclosure of a major sector of the U.S. economy—automotive products—from international competition would violate clear and specific commitments made under the GATT, and would cast doubt on the viability of the international trading system which has sustained the growth of world trade for decades.

Let me now address more specifically the consequences of H.R. 5133 for trade relations with other nations. A fundamental problem of H.R. 5133 is that it directly violates the GATT rules. Article III, Sections 1 and 5, of the GATT together prohibit the parties from adopting laws which, to protect domestic production, require ". . . directly or indirectly, that any specified amount or proportion of any product . . . must be supplied from domestic sources." And H.R. 5133 is incompatible with Article IX, which prohibits, with exceptions not relevant here, the imposition of quantitative restrictions on imports.

In the event that H.R. 5133 should contain a provision—as originally introduced—permitting Canadian automotive products to qualify as "local content," thereby extending special treatment to Canada, the proposal would also violate the "most favored nation" provision of the GATT, which basically requires that a trade benefit extended to one GATT member be extended to all GATT members. If the new version of H.R. 5133, which subjects Canada to the same local content requirement as other countries, were to be adopted, it would violate both the GATT and the U.S.-Canada Automotive Products Agreement under which each government agreed to avoid actions that could frustrate the objectives of an open and integrated automotive market.

The probable outcome of the enactment of H.R. 5133 would be the filing of a formal complaint in the GATT by an injured country seeking compensation from the United States. We think it virtually certain that the U.S. local content law would be held to violate GATT to institute restrictions on designated imports from the United States.

Among leading U.S. exports identified by the Administration which might be affected by such action are aircraft, office equipment, electrical components, corn, wheat and soybeans.

Alternatively, an injured country might elect to take more direct action either by buying less U.S. products and purchasing the balance elsewhere, or by imposing tariffs or quotas on U.S. goods without GATT sanction, or by establishing non-tariff barriers to the entry of U.S. products. Whatever the form the retaliation takes, the result will be a loss of U.S. exports and of export-related U.S. jobs.

While it is difficult to estimate the number of jobs which will be lost as a result of retaliation, it is virtually certain to be at least as great as any hypothetical employment gain H.R. 5133 might bring about. Because each $1 billion in exports accounts for over 25,000 jobs, the loss of even $4 billion in exports would cost the United States 100,000 jobs.

In addition to these export and job losses resulting from direct retaliatory action by our trading partners, we are deeply concerned that the imposition of a local content law in the United States, protecting a major sector from foreign competition, will encourage the proliferation of similar restrictions abroad, both by national and local governments. Local content laws and "buy national" practices abroad are already a pervasive impediment to U.S. exports. For example, under the Canadian Foreign Investment Review Act, many U.S. companies have been restricted from investment in Canada unless they agree to purchase unreasonable quantities of Canadian components. Other examples abound.

If the United States builds a fence around a major industry through a local content law, in direct violation of GATT, is there any reason why our trading partners should not do likewise? And should the United States file a complaint in the GATT against retaliatory "buy national" laws or practices of foreign nations, it is unlikely that relief will be granted as long as the United States itself remains in violation of GATT rules.

H.R. 5133 would also directly undercut administration efforts to encourage trade liberalization measures by other nations. The U.S. Trade Representative is presently engaged in negotiations with Canada for the purpose, among others, of reducing "buy Canadian" conditions imposed by the Canadian government on foreign investors. Similarly, U.S. negotiators are working with Japanese government officials to reduce institutional and cultural barriers to imports. And at the GATT Ministerial meeting in November, the United States will seek to liberalize world trade in agricultural commodities, in the services industry and in high technology. The imposition by the United States of a barrier to international trade in automobiles will undermine our negotiating position, defeating United States' efforts to obtain reductions in other nations' trade barriers.

We are also concerned that the adoption of a local content law for automobiles will lead to pressures for additional Federal "local content" laws applicable to import-vulnerable American industries. If these laws proliferate, reduced competition, higher prices and more trade conflicts with foreign nations will follow, leading to higher levels of retaliation and, ultimately, trade stagnation.

Moreover, the adoption of a local content law for automotive products by the U.S. Congress will lead to increased pressures on State legislatures to adopt "buy American" statutes, which will have similar effects.

To sum up, enactment of H.R. 5133 would encourage protectionist forces everywhere and open the way to a surge of trade restrictions and loss of employment throughout the world, not least in our own country. In its most recent annual economic review, just released, the GATT has warned that the world economy is in its worst state since the 1930's and that protectionism poses a growing danger to growth of trade. That danger would be magnified by the adoption of protectionist legislation in the United States.

We strongly urge that Congress defeat H.R. 5133. Thank you.

Chairman GIBBONS. Yes, sir. I agree with you. This legislation is kind of like a case I once tried for a man who was convicted of manslaughter for drunken driving. When we got down to talking about his defense, about the only defense he had was, "Well, everybody else drives and gets drunk; therefore, I guess that is about my best defense" Well, that didn't work. This bill won't work. What really infuriates me about this bill is what you pointed out, Mr. Roberts. Next year it is not going to be just cars. This bill will not pass this year. There is physically no way it can get to the President's desk by the end of this Congress.

But next year, it will be back. Next year it will not only be cars but steel, garments, shoes, might even be some more dairy products. There will be no end to it.

What really infuriates me about the bill is that we have the highest paid management in the world, and second highest paid labor in the world asking us to support them like they would like to be supported. I represent a half million people. I don't have anybody in my working class people or in my management class people that draw any kind of salaries like this. They work, many of them, with a lot more skill and just as good a managerial ability as these people have exhibited. Yet they are coming in here saying, "Support us like the kings and potentates we think we are. Let us continue to turn out our shoddy products."

Those aren't my words. Those are the words of thousands of people who have turned away from them. I have never seen such a piece of economic aggression by one set of Americans against another set of Americans in all the 30 years that I have been in a legislature. This has to be the worst. So I appreciate you and Mr. Greenbaum coming in here. You are just defending your own businesses and your own interests against some people that I think are plain economic aggressors in our society.

If you would like to respond to any of the observations I made, I would be happy to hear them.

Mr. GREENBAUM. Mr. Bailey spoke of pride in the country and accepting the competitive challenge. We, too, have pride in this country, but our country would be saying, under the concept of this bill, that the U.S. automobile industry is seen as a permanently noncompetitive industry, unable to survive without permanent powerful protection. We are no longer asking the automobile industry for time to become competitive in car size and car quality, in cost efficient production. This bill would give the industry the ability to ignore the challenge of foreign competition.

I don't think this is what Congress intends or is the direction for our economy which should be responsiveness to the discipline of market forces. We do have problems of market access in Japan, but let us look at our errors and sins of omission in this country, things much more easily controlled by our Congress, our executive branch, and our own people. This should be our first priority, a budget that is conceived of as out of control, leading to these horrendous interest rates; and education in science and math and foreign languages that is not internationally competitive.

How are you going to win the race when you are condemning yourself to a second-rate force of scientists and engineers compared to those of other countries?

These are things we should be addressing, too. I do not mean to turn our back on things that are difficult. We have to fight those things, too. We have to be internationally competitive in our rules on research and development, on taxation, and on investment. We are in an international market. We cannot do things and view things in isolation or we will continue to take the shellacking that we are taking now.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. I want to thank the witnesses for excellent testimony.

Mr. Roberts, your testimony included the statement that the mentality that expounds this kind of a bill believes that the other nations will rollover and either do what fortress America wants, or that Fortress America will get along fine without them.

What will happen in the real world if they don't agree, and simply enact this sort of thing right back in?

Mr. **Roberts**. Your question is, what will we do if other nations——

Mr. **Frenzel**. In the trading world, what if we throw out the gauntlet of local content, and the other countries do not roll over and play dead?

Mr. **Roberts**. We foresee a group of hostile pieces of legislation in countries that are the most deeply affected by the loss of the U.S. auto market.

We do not know against what products such retaliation might take place.

It might be in the realm of agriculture or high technology.

We certainly won't want to give them any ideas, but the administration has identified a number of areas where our exports are high, and where we are vulnerable.

It is possible that instead of anything as overt as legislation, that subtle nontariff barriers to U.S. goods and services may arise that we only recently have succeeded in negotiating down.

It may be that decisions would be made by governments and major companies, and among our trading partners, to simply buy part of their needs elsewhere rather than the United States.

In either event, we can see a period of trade stagnation in those areas with the loss of export-related jobs in the United States; so that I hate to be one who has no kind word to say for this bill, but it spells trouble in terms of the reaction of other countries.

One example is the difficulty which the United States currently faces with its pipeline sanctions.

Now, this is a terribly complex subject, but, as you know, one of the most sensitive nerves that we appear to have touched in Europe is employment. There are people who need the work that would have been produced had those sanctions not gone into place, and so the reaction was exceedingly strong, and this suggests to us that we may find similar very surprisingly strong reactions to such a forceful initiative of the United States.

Mr. **Frenzel**. In the case of the steel cases, where at least there was some basis for the American action, American law is consistent with GATT, which found their action in Europe to be overpowering. In the case of local content, there is no basis in existing American law, and it is certainly inconsistent with GATT, and it seems to me the reaction will be powerful and harmful. Is that your conclusion?

Mr. **Roberts**. Yes, sir.

Mr. **Frenzel**. Could you describe the National Foreign Trade Council, who its members may be, and how many there may be?

Mr. **Roberts**. We have over 600 members, large companies and small, and while it is difficult to make a proper calculation, we think that they represent well over half of all U.S. exports of manufactured goods and services.

Mr. **Frenzel**. That includes exclusively exporters.

Mr. **Roberts**. It includes a great many multinational corporations that are exporters and importers which have investments abroad everywhere.

Mr. **Frenzel**. Thank you very much, Mr. Roberts.

Mr. Greenbaum, tell us about the American Association of Exporters and Importers and its size and the scope of its members' activities.

Mr. GREENBAUM. We have approximately 1,400 members engaged in exporting, importing, and domestic manufacturing.

Some are solely importers. I don't think we have any at this present time who are solely exporters.

There are very small companies, and there are many of the best known companies in this country among our membership.

Mr. FRENZEL. I was interested in your followup statement in which you indicated that this was a permanent protection business, and would put the automobile industry in about—well, it would permanently enshrine them as a buggy-whip manufacturer, I suppose; that it can't ever stand up and walk on its own two feet. Is that the impression you meant to convey?

Mr. GREENBAUM. Yes, sir; there seems to be no sunset in this legislation.

Mr. FRENZEL. They would be protected in perpetuity from any kind of competition, good, bad, or indifferent, unless it happened to be exactly the same as it, itself, could provide.

Mr. GREENBAUM. Yes, sir.

Mr. FRENZEL. Well, I have to say, too, that it is a bit of an overstated effort, but as Mr. Bailey says, perhaps there is a reason for that.

The sponsors are really only trying to educate us.

It is a lesson, and I think it would be a very stern one.

I thank you for your excellent testimony, and I yield back the balance of my time.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

I am going to make a statement, Mr. Greenbaum and Mr. Roberts. I would very much like you to respond.

Part of the reason for this legislation indeed is that it is a reaction. That is quite correct.

I find myself on the inside very irritated by the attitudes that you folks have expressed here, taking this country to task, as if somehow we are originating some type of protectionist idea here.

It really irritates me.

Mr. Greenbaum, you went through a litany of things. You want to talk about this and solve this problem with education and that problem with skills.

You have got to excuse me, I want to check and see I don't get my temper up in answering you.

Mr. GREENBAUM. I am sorry.

Mr. BAILEY. You touched on some very correct things. I would love to sit down and take your philosophy apart and take down what political responses, perhaps not you, but your membership, has made to some of these very same difficulties, for example, with student loans.

You threw in a little thing about taxation and investment policy. I wish you would spend a little bit more time here in the audience and maybe give some support to some of us who have tried to fight to make this Nation competitive in those compartments, because we are not in those areas. That is the reason this damn piece of legislation is being brought before this committee. That is why people like myself, who know darn well that it is anything but an ideal response, are simply pulling their hair out and trying to say we have got to do something, because all those root causes are exactly what has caused this society to be so victimized; so why don't we do something about the root causes?

The indicia of free enterprise, the things that define it vary from person to person and from country to country, and we have a certain free enterprise model here that we think is worthwhile, because we think it approaches best the efficiency we would like to see in resource allocation within any economy anywhere.

That is the reason why this bill is before the committee; not because it is some protection for some special self-appointed groups of people who want to exclude everyone from the largesse they would like to gain.

Talking about labor, I find myself, when the tangential arguments get fed into this thing, setting the record straight. It is a never-ending task.

The labor force in most countries indeed in Japan, we are talking about overall the most highly skilled portion of the work force. People have a view of automobiles, where they think it is just a case of assembly lines and tacking something together. They don't know about the machine shops, the industrial engineering, and all the work that goes into this industry.

I think that if you go to Europe, for example, you will find that benefits and packages and wages are generally about the highest of most industries in producing a commercial product in transportation. You also find that in Japan, to the best of my knowledge. They basically are represented well, they are well paid, and their benefit packages are higher than average. That is a reflection of the nature of the industry as much as anything else.

I would like to get at some of those root causes, and I have worked on investment tax credits for everything, from skilled labor. This country is terribly short of skilled labor right now. You folks may be aware of that. You want to know what we are doing about it?

Absolutely nothing. What we do is we fill the halls of Congress and our television speeches with rhetoric about what free enterprise means, but we are not very bright about what free enterprise means here in competition with what it means in Europe, or in Japan.

Take that real problem, OK, and instead of sitting here and talking about who is victimizing who, let's look at the Nation's interest as a whole, and what do you do?

This Nation, to its credit, has pushed very, very hard to try and open markets for countless years. We have cajoled, threatened, and sometimes been through what we consider to be a little bit tough, but not really to any degree of success. Partly we have exported policies that have caused the problem. We created the world oversupply of steel. At least we had a hand in it. We come down here as politicians, and we want to beat the union, the management, the private sector, over the head for it.

I want you to respond to this.

You folks decide out there what relationship, what role and what function you want for government. That is really the issue here. You want skilled students?

Mr. GREENBAUM. Yes.

Mr. BAILEY. Well, then, we better start doing something with educational policy to supply them. I have introduced a number of bills to do that. I may be denounced as interfering with free enterprise and freedom of education. I have bills sitting and languishing in committee, that will provide job tax credits for skilled labor. Do you know what it is like to train a machinist? What it costs?

When we passed this tax bill, there was not room in it, because what we were interested in were bottom line today figures and not what the word productivity meant, not any discussion about the role of government.

I will tell you something right now, to characterize this bill as some kind of a special legislation for a special interest group is overdoing it a little bit.

It can be criticized partially on that basis, but an honest evaluation of it, what it does, you have to say a great deal more.

I don't care whether you pass this legislation or not. In 10 or 15 years, we are going to be desperately short of engineers.

We are right now short of engineers and short of skilled laborers and machinists. We have no policy to deal with it at all.

I got a personal handwritten letter yesterday, or day before yesterday, from Mr. Brock, and was very flattered by it, a very nice letter disagreeing with me completely in terms of this bill and policy whatsoever.

Talking about some of the problems that were brought up in the discussion, every single capital-intensive industry—and you fellows don't trade in those areas—every single major capital-intensive industry is in trouble in the United States of America, and the Nation cannot militarily survive without them.

We cannot. Solve that problem for us.

When you look at why they have those difficulties, you understand why this bill, it seems to be out of context, but that is where it is coming from.

How are you going to have, as private industry, your cake and eat it, too?

Transferability, refundability is bad; targeted industries are bad.

Research and development, in aggregate numbers, we spend more in research and development than the Japanese, but if you look at what they target on, and you look at the percent relationship, and in their society, we look sick beside them, and you are agreeing.

Let the record show that you are shaking your head in agreement.

Mr. GREENBAUM. Yes, sir.

Mr. BAILEY. OK. What do we do to try to get at some of these root causes? I know you are going to say that the last thing in the world you do is pass this bill.

That is a given. Let's not waste our time on that, because it is so evil, and terrible, and bad, but it is a response to these other problems that plague people like myself.

Equalize taxation; the chairman spoke about value-added tax issue, and Mr. Frenzel spoke on those same things, and we know the practical problem.

We just passed a tax bill for nothing more than lousy blatant political purposes, and we still have minimum corporate taxes written in our bill.

Mr. Reagan is supposed to stand for good investment purposes. Everybody knows that a minimum corporate tax is nothing more than a lousy penalty.

It was tagged on because it wanted to tax individuals who are running out of the country and use foreign tax shelters, et cetera.

That is what it was done for. We are talking about policies, hypocrisies, and all that kind of stuff. We are not going to get anywhere.

What do we do as an alternative so that this free enterprise model that the Japanese may decide someday that free trade is a good idea. Is the best way to deal with it to turn the other cheek, or what?

I would like to do a lot of the domestic things that you alluded to. That would disrupt free enterprise.

I raised very few questions, so you can be brief.

Mr. GREENBAUM. Certainly we must say that we had no intention of offending you.

Mr. BAILEY. When you say those things, you ought to realize that there are people that love and believe in free enterprise and would like to see broader issues.

If you talk about Japan, a free enterprise model, and you talk about American trade in that context, as if you will let the free market operate, then, damn it, you better define free market as it is defined here and over there.

I don't think you folks do that fairly when you come in here to talk about these issues. You know that.

You've got to talk about some broader problems when you talk about these things. You can't sit there and play seventh or eighth grade. We have graduated.

You alluded to those things.

What do you do? What do you want us to do? You want some more research and development; then we ought to write that tax code differently and apportion more resources that way instead of getting hung up on third-year personal tax cuts, like that is a panacea.

Maybe we need to sit down and cut that economic pie a little better.

The chairman headed up a tax forum on an expensing proposal that was the dream of American business, but, because it was politically presented in an unfortunate political environment, it was rejected, and yet it was a dream.

It would have been the major change we could have made in years. Were you fighting for that one?

Mr. GREENBAUM. This is not the first day we have spoken of these issues. Our 1,400 members do not represent the heart of the American power structure but I do know that the chief scientist of IBM was in these halls testifying as to the deficiencies, the competitive deficiencies, in our engineering and scientific education.

Some of the big companies have sought to alleviate this with grants to universities to establish professorships, to hold on to the engineering faculty. Those are good things, but I agree, they are not enough. We have to have some revision of our priorities, and we don't look for a MITI, a Japanese-type organization, but we have to use some intelligence in anticipating our problems and speaking to these problems.

Certainly we have to have some kind of way at the beginning, at the high school level, if not sooner, of getting enough math and science teachers, make it interesting enough. There is some good education work being done in private industry today for their own private ends, educational technique that would be very valuable, I am sure.

We need to reassess a whole host of national priorities and we have felt the foundation of a prestigous commission and I am not talking about stalling for 10 years, but to get an overall view of what our problems are and go after them and remember, this isn't fortress America.

I am not talking social equity, but how are we going to compete in this world?

Mr. BAILEY. I can say this to you, sir. One of the major complaints about the Japanese success, and the American fear of Japanese success has been their ability to really industrially plan and industrially apply their technology, technology applications, as you know.

There is absolutely, in my opinion, no problem more real than the shortage of skilled technicians and skilled machinists in this country, and it shows up where you are rich on ideas but short on the way to implement them, to apply your technology and get it in that factory and get it working; not just corporate functions, capital shortages, not union intransigence.

I have established a clear record here from those who have testified, there has never been an impediment by the United Auto Workers or the Steel Workers in their industry. That is an important point.

We do not have a facility out there in this country for training people for those kinds of jobs. I have studied it thoroughly and looked for ways to write it into our military system.

I have tried to present issues here before this committee and every member has a different idea about what is good and bad, just like me, and it is hard to get it through but the very heart of this country's ability to compete out there is being gutted.

It is declining. We are good at making hamburgers, good at marketing and advertising. That is not going to get it.

I caught you unaware. I am being very unkind to you and I apologize. When you develop some ideas on what to do and how to do it, that will really do the job aside from just voicing the love that we all have for free enterprise, please write and let the chairman know, because he would do his best to get them changed.

Chairman GIBBONS. Thank you, gentlemen.

Our next witnesses are the National Association of Manufacturers, Mr. Lawrence Fox, vice president for international economic affairs, and Chamber of Commerce of the United States, Frederick

Stokeld, director for international economic policy. He is accompanied by Mr. Rooney.

While you gentlemen are taking your places, I would ask the reporter to put this in at the end of the record. We have a statement here by Thomas W. Gleason, international president of the International Longshoreman's Association of the AFL-CIO.

While I have not yet had a chance to read it all, it looks very interesting, and I will read it later.

Mr. Fox, go right ahead.

STATEMENT OF LAWRENCE A. FOX, VICE PRESIDENT FOR INTERNATIONAL ECONOMIC AFFAIRS, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Fox. Thank you, Mr. Chairman.

I am Lawrence A. Fox, vice president for international economic affairs of the National Association of Manufacturers. I should like to say at the outset that we consider these hearings extremely important and appreciate very much the opportunity to testify.

Mr. Chairman, I have a summary of my remarks which I would like to read to the committee, and if the full statement will be made part of the record.

Chairman Gibbons. Yes, sir, we will put your full, entire statement in the record.

Mr. Fox. The National Association of Manufacturers firmly opposes enactment of H.R. 5133. This past summer, it became apparent to us, our members, and many others that the effort to impose on the United States and the world economy and the dangerous trade restraints contemplated by the domestic content bill had to be taken very seriously.

On July 15, the NAM International Trade Policy Committee met in special session to review this legislation. Our committee approved a strong resolution of opposition. I do not plan to read this to you but rather to discuss its key elements. I would, however, be grateful if both the resolution and a letter I sent to Congress on this subject could be included in the record.

I am, of course, aware that the bill under consideration today is not identical to that which the NAM trade committee considered in July. The result is still a severe quota for major foreign producers, albeit a higher one. Moreover, the revision does not address our major objection, namely that the bill would involve the United States in a flagrant violation of the GATT.

The bill's apparent emphasis on automotive products is deceptive. H.R. 5133 has implications for all manufacturing sectors and for the conduct of U.S. economic policy both domestically and internationally. The legislation provides a grant of immunity from foreign competition to one segment of the economy.

It is naive to think that, if this bill were to become law, Congress and the administration could long resist the pleas for similar favors from other sectors. We are neither sanguine nor unconcerned about the serious difficulties of the U.S. automobile industry and the men and women who work for it. Our objection is to legislation that seems to ignore options of both U.S. law and international law and the realities of American national interests.

To assume, as the legislation implicitly does, that we do not need trade or that we can afford to rest in our efforts to achieve a more open trading system is autarkic foolishness. If, for example, one were to subtract from the 1981 merchandise trade account both our petroleum imports, valued at $18.5 billion, and our exports to OPEC countries valued at $21.5 billion, the result would be a U.S. trade surplus of $18 billion. But we need the oil and we need to pay for it. We need the oil, the export earnings, and the jobs. Roughly 20 percent of U.S output is exported, and in manufacturing alone some 4.8 million Americans earn their livelihoods producing for export. Last year the United States earned $233.7 billion from exports, $154.3 billion from the export of manufactured goods.

I do not mention these facts simply to highlight the dangers of retaliation, which can be exaggerated. Granted, the legislation represents such clear and significant violations of our obligations under articles III and XI of the GATT that retaliation cannot be discounted, and granted too that H.R. 5133 would put at risk more jobs than it could reasonably be expected to save or create.

The fact, however, that the United States has vital interests in the international trading system is something that needs to be appreciated in and of itself. Ignorance of this point is the Scylla of U.S. trade policy. The Charybdis is the notion that our trade problems are self-correcting and that American exporters require only benign neglect from U.S. policymakers.

Industrial strength and export competitiveness are not attributes of an economy that can simply be taken for granted. It concerns us, and we believe it should concern the Congress and the administration, that Japan and Germany dwarf the United States in their ability to generate surpluses in their trade in manufactured goods. In 1981, Japan's surplus in manufactured goods was $115.6 billion, Germany's $61.7 billion, and ours only $5.3 billion. In 1982, it is doubtful we will have any manufactured surplus at all.

Even if the domestic content legislation ultimately fails, as we hope it will, the debate over it will have been an expensive exercise. It is all too likely that Congress will present the President with a domestic content bill, which can only hurt American competitiveness, but will not complete action on any positive measure for improving U.S. competitiveness. A few examples should illustrate the point.

THE YEN

The dramatic undervaluation of the yen, or put differently, the failure of the changes in the values of the yen and the dollar to reflect the changes in the competitive strength of Japan and the United States, has resulted in an economic challenge of the first order. This misalinement of currencies has, of course, contributed to the price advantage of Japanese automobile manufacturers in the United States, perhaps on the order of 20 to 25 percent.

But its importance goes beyond that. It affects U.S. competitiveness in every market of the world. Left uncorrected, it threatens the U.S. industrial base. We have raised this matter with the administration, and it is our hope that the appropriate committees of the House and Senate will consider the problem in depth at the earliest possible moment.

EXPORT TRADING COMPANIES

This legislation, having been debated by two Congresses and in this present one having been passed by both the House and Senate, appears again in danger of dying on the legislative vine, this time for lack of the necessary House-Senate conferences.

It is worth pointing out that at least one study, that by Chase Econometrics, projected that by 1985, ETC legislation could add anywhere from 320,000 to 640,000 new jobs. In short, the ETC legislation has a lot more job creating potential than anyone but the UAW is willing to claim for the domestic content bill.

EXPORT-IMPORT BANK

Failure to appropriate adequate funds for the Export-Import Bank is strangling U.S. exports of big-ticket items, especially capital goods and certain high-technology equipment and systems. Only about 5½ percent of U.S. exports benefit from Eximbank and other official export credit programs, whereas the comparable figure for Japan is close to 40 percent. I urge the Congress to give this problem the high priority it deserves.

FOREIGN CORRUPT PRACTICES ACT

It should be clear by now that in its present form this law hurts American exporters. Many in the House and Senate have been working hard for the last 2 years to amend existing law in a manner that will improve competitiveness without sacrificing principle. This efort, too, may fail.

THE RECIPROCAL TRADE AND INVESTMENT ACT

This is legislation that could, over time, insure a closer relationship between policy initiatives and national priorities, provide a useful toughening and clarification of section 301 of the 1974 Trade Act, and give clear congressional support for U.S. negotiating positions at the GATT ministerial.

This is a short list of approaches to trade problems that are more worthy of attention. With the exception of the exchange rate problem, it is confined to legislation which could be enacted in this Congress. There is, however, another set of alternatives that needs to be addressed because it bears directly on the issue at hand. I refer to the relationship between this legislation and section 201 of the Trade Act of 1974 and further to the relationship between section 201 and article XIX of the GATT.

It has been almost 2 years since the International Trade Commission made the determination that imports were not a substantial cause of injury to the U.S. automobile industry, and so it is open to the UAW or the industry to petition the ITC anew under section 201.

Notwithstanding the inherent difficulties of meeting the substantial cause test, it seems possible to us that the continued weakness of the U.S. industry and the ability of imports to capture an ever larger share of the U.S. market might now permit a different finding by the Commission. On the other hand, given the expense and the uncertainty of the outcome, industry reluctance to pursue this course again would be more than understandable.

These factors, however, need not be a bar. Under the law, the President, the USTR, the Senate Finance Committee, and the Ways and Means Committee all have the power to request an ITC investigation under section 201. In short, Congress, which can pass H.R. 5133, can also open a new ITC case.

Separately, if the Congress were to conclude that section 201, as drafted, makes it virtually impossible for an industry like the automobile industry to obtain relief, then perhaps Congress should consider amending the statute. GATT article XIX, which exists because the United States insisted upon it and which provides the analog in international law to section 201, is much less restrictive than section 201.

One of the problems of the latter is that it appears to make important relief impossible in a recession since the recession will in most cases be seen as a greater cause of the industry's difficulties than imports. This particular version of Catch-22 seems to have been avoided in GATT article XIX.

Commonsense suggests that it is unwise to regard international trade as a competition in virtue. Certainly, it makes sense for the United States to try to improve the international trading system and to work to strengthen the legal framework within which most trade takes place. It does not make sense, however, for domestic law to anticipate these improvements. The United States need not restrain itself on important relief beyond the requirements of the GATT.

Having said this much, it is important to add that I am not today advocating either a committee resolution directing the ITC to open a new 201 case or changes in section 201. I am suggesting that these options, which are consistent with U.S. international obligations, be thoroughly explored before the country adopts legislation such as H.R. 5133, which clearly violates international law.

It is a big gamble, but proponents of the legislation may be correct in arguing that the value of the U.S. market to Japan is such that Japan is unlikely to risk a rapid escalation of U.S. import restrictions by retaliating against domestic content legislation.

On the other hand, Japan may feel that retaliation offers the only hope of containing this protectionist response to imports. In any event, the greater danger is that the legislation will undercut not only U.S. negotiating efforts in the GATT but efforts of those policymakers around the world who daily argue against protectionist solutions to economic problems.

The trading system can be likened to a city police force. The level of crime with which we are all familiar inspires a certain cynicism with respect to the efficacy of the police. But the existing condition of our lives are far to be preferred to the chaos that results when there are now laws and no police.

We are well aware that GATT rules are frequently honored in the breach; that local content requirements are not unknown even in the OECD—Greece, Turkey, Spain, and Australia have them—that France, Great Britain, and Germany all have so-called voluntary restrictions on automobile imports, as does the United States; and that the Japanese automobile industry, clearly now the world's most competitive, was built up under conditions of almost 100 percent protection.

Surely these measures flout the spirit if not the letter of the GATT and just as surely the system would be strengthened if these and similar measures in other countries and on other products could at the very least be notified to GATT, preferably under the provisions of a new safeguards code. NAM has consistently supported such a code, and we hope it remains high on the list of negotiating objectives for the GATT Ministerial Meeting.

The suggestion that because the United States currently benefits, if that is the right term, from Japanese export restraint in automobiles renders us unable to push for a new code is in my view without merit. Certainly, though, enactment of H.R. 5133 would make such an effort by the United States seem quixotic if not arrogant.

This legislation is directed primarily at Japanese exports and understandably so. Many U.S. companies are distressed by the nature of our trading relationship with Japan. Indeed, NAM's International Trade Committee expressed this viewpoint in the resolution opposing domestic content. It reads as follows:

> Recognizing that domestic content legislation has been inspired in large measure by Japanese policies that have unjustifiably burdened U.S. commerce, the National Association of Manufacturers urges the Congress and the Administration to take appropriate action with respect to these policies at the earliest possible moment.

Finally, one of the more provocative commentaries on the unhappy relationship between Japanese policy and U.S. competitiveness, now under consideration by the administration, is the *Houdaille* case. This provides an illustration of an often-overlooked element in Japanese industrial policy: that is the selective disregard of competition laws and the explicit encouragement of cartels.

The petition is for relief under section 103 of the Revenue Act of 1971 and was filed last May by Houdaille Industries of Fort Lauderdale. Houdaille, an important machine tool builder that has seen the Japanese shares of critical U.S. markets rise dramatically in recent years, has asked the President to deny the investment tax credit for the purchase of numerically controlled, NC, machining centers and numerically controlled punching machines from Japan.

Between 1976 and 1981, Japan's share of the United States numerically controlled machining center market went from 3.7 percent to over 50 percent, and in NC punching machines, their share rose from 4.7 percent to 37.6 percent.

Much of the petition is devoted to a description of the Japanese machine tool cartel and the manner in which it has been sheltered and nurtured and subsidized by the Government of Japan. The issues raised by this petition, which NAM supports, are important for all of U.S. manufacturing.

A common threat with the automobile industry, for example, is the question of whether foreign industries that come to maturity under virtually full protection from international competition are to be accorded the same privileges in the marketplace as those which have had to deal with foreign competitors from their inception. The issue is an important one, especially now for America's high-technology industries.

For the sake of this and other issues, we feel that the *Houdaille* case bears scrutiny by Congress as well as the administration, and I should be grateful if the comments NAM submitted to the USTR could be included in the record of this hearing.

I have said as much as I have about the *Houdaille* case because it highlights our deep concern over several aspects of U.S. trade with Japan. These are serious problems which urgently need to be addressed. That does not mean, though, that the United States or U.S. industry can afford solutions like H.R. 5133, which ignore and so jeopardize the benefits we receive from international trade.

Again, I thank the subcommittee for this opportunity to testify.

[The prepared statement and additional material follow:]

STATEMENT OF LAWRENCE A. FOX ON DOMESTIC CONTENT LEGISLATION

Mr. Chairman, members of the subcommittee, I am Lawrence A. Fox, Vice President for International Economic Affairs for the National Association of Manufacturers. I should like to say at the outset that we consider these hearings extremely important and appreciate very much the opportunity to testify. In our view, the domestic content legislation, or more formally the "Fair Practices in Automotive Practices Act" H.R. 5133, is primarily a trade bill. We share with the Chairman a certain regret that this legislation was not in the first instance referred to the Ways and Means Committee and to this important subcommittee, which has both special responsibilities and considerable expertise in matters relating to international trade. The Subcommittee is to be thanked and congratulated for the excellent job you have done in difficult circumstances. Personally, I am especially grateful to you Mr. Chairman and to Mr. Frenzel and Mr. Jones for requesting the Congressional Budget Office analysis of H.R. 5133. This has been of considerable assistance to us in refining our views on this legislation, and I shall have occasion to refer to it again in my testimony.

The National Association of Manufacturers firmly opposes enactment of H.R. 5133. This past summer it became apparent to us, our members, and many others that the effort to impose on the U.S. and world economy the dangerous trade restraints contemplated by the domestic content bill had to be taken very seriously. On July 15, the NAM International Trade Policy Committee met in special session to review this legislation. Our committee approved a strong resolution of opposition, and as the members of the subcommittee know, I forwarded a copy of the resolution to every Representative and Senator under cover of a letter of July 22. I do not plan to read the resolution but rather to discuss with you its key elements. I would, however, be grateful if both the NAM resolution and the letter could be considered part of my testimony and included in the record of this hearing.

I am, of course, aware that the bill under consideration today is not identical to that which the NAM Trade Committee considered in July. I would agree, though, with an observation made to you last week by Ambassador Brock to the effect that the substitute version of H.R. 5133, which was reported out of the House Committee on Energy and Commerce on September 20, does not render the bill any less objectionable. Referring to the original bill, the CBO study noted that, "The practical effect of the bill (H.R. 5133) would be the imposition of a rigid import quota on each foreign auto producer." To be sure, the revised version of H.R. 5133 is less draconian. Dr. Rivlin pointed out in her testimony last week that "domestic content of around 25% as defined in H.R. 5133 will be fairly easy for foreign automakers to achieve by 1990." The result is still a severe quota for major foreign producers but a higher one. Moreover the revision does not address our major objection to the legislation, namely that it would involve the United States in a flagrant violation of the GATT. A point that needs to be made in any discussion of this legislation is that the bill's apparent emphasis on automotive products is deceptive. H.R. 5133 has implications for all manufacturing sectors and for the conduct of U.S. economic policy both domestically and internationally. The legislation provides a large, and largely unsought, grant of immunity from foreign competition to one segment of the economy. It is naive to think that, if this bill were to become law, Congress and the Administration could long resist the pleas for similar favors from other sectors. We are neither sanguine nor unconcerned about the serious difficulties of the U.S. automobile industry and the men and women who work in it. Our objection is to legislation that seems to ignore options of both U.S. and international law and the realities of American interests.

To assume, as the legislation implicitly does, that we do not need trade or that we can afford to rest in our efforts to achieve a more open trading system is autarkic foolishness. If, for example, one were to subtract from the 1981 merchandise trade account both our petroleum imports, valued at $78.5 billion, and our export to OPEC countries, valued at $21.5 billion, the result would be a U.S. trade surplus of $18 billion. But we need the oil and we need to pay for it. We need the oil, the export earnings, and the jobs. Roughly 20% of U.S. output is exported, and in manufacturing alone some 4.8 million Americans earn their livelihoods producing for export. Last year the United States earned $233.7 billion from exports, $154.3 billion from the export of manufactured goods.

I do not mention these facts simply to highlight the dangers of retaliation, which can be exaggerated. Granted, the legislation represents such clear and significant violations of our obligations under Articles III and IX of the General Agreement on Tariffs and Trade that retaliation cannot be discounted, and granted too that H.R. 5133 would put at risk more jobs than it could reasonably be expected to create. The fact, however, that the United States has vital interests in the international trading system is something that needs to be appreciated in and of itself. Ignorance of this point is the Scylla of U.S. trade policy. The Charybdis is the notion that our trade problems are self-correcting and that American exporters require only benign neglect from U.S. policy makers.

Industrial strength and export competitiveness are not attributes of an economy that can simply be taken for granted. It concerns us very much, and we believe it should concern the Congress and the Administration, that Japan and Germany dwarf the United States in their ability to generate surpluses in their trade in manufactured goods. In 1981 Japan's surplus in manufactured goods was $115.6 billion, Germany's $61.7 billion and ours only $5.3 billion. In 1982 it is doubtful we will have any manufactured surplus at all.

Even if the domestic content legislation ultimately fails, as we hope it will, the debate over it will have been an expensive exercise. The run-up to an election is always a critical period. Generally speaking, it is when things happen. In this case, it seems the wrong things are happening. It is all too probable that Congress will present the President with a domestic content bill, which can only hurt American competitiveness across the board, including the competitiveness of the automotive sector, but that Congress will not complete action on any positive measure for improving U.S. competitiveness. A few examples should illustrate the point.

The Yen. The dramatic undervaluation of the yen, or put differently the failure of the changes in the values of the yen and the dollar to reflect the changes in competitive strengths of Japan and the United States, has resulted in an economic challenge of the first order. This misalignment of currencies has, of course, contributed to the price advantage of Japanese automobile manufacturers in the United States, perhaps on the order of 20–25%. But its importance goes beyond that. It affects U.S. competitiveness in every market of the world. Left uncorrected, it threatens the U.S. industrial base. We have raised this matter with the Administration-attached for the record is a copy of a letter NAM's President, Alexander Trowbridge, recently sent to Secretary Regan—and it is our hope that the appropriate committees of the House and Senate will consider the problem in depth at the earliest possible moment.

Export Trading Companies: This legislation, having been debated by two Congresses and in this present one having been passed by both the House and Senate, appears again in danger of dying of the legislative vine for lack of the necessary House-Senate conferences. NAM has never argued that the export trading company legislation alone could solve the U.S. trade problem, but we do believe it can help. The bill involves more a grant of freedom than a specific plan, and the contributions it can make to the growth of the U.S. economy cannot be charted with precision. It is nevertheless worth noting that at least one study, that done by Chase Econometrics, projected that by 1958 ETC legislation could add anywhere from 320,000 to 640,000 new jobs. In short, the ETC legislation has a lot more job creating potential than anyone but the United Auto Workers is willing to claim for the domestic content bill.

Export-Import Bank: Failure to approriate funds for the Export-Import Bank is strangling U.S. exports of big-ticket items, especially capital goods and certain high technology equipment and systems. Only about 5½% of U.S. exports benefit from Eximbank and other official export credit programs, whereas the comparable figure for Japan is close to 40%. I urge the Congress to give this problem the high priority it deserves and attach testimony I gave on this issue before the Senate Banking Committee on September 14.

Foreign Corrupt Practices Act: It should be clear by now that in its present form this law hurts American exporters, and many in the House and Senate have been working hard for the last two years to amend existing law in a manner that will improve competitiveness without sacrificing principle. This effort too may fail simply because the legislation does not enjoy the priority necessary to squeeze it through in the last days of this session.

The Reciprocal Trade and Investment Act: This is legislation that could, over time, ensure a closer relationship between policy initiatives and national priorities, provide a useful toughening and clarification of Section 301 of the 1974 Trade Act, and give clear Congressional support for U.S. negotiating at the GATT Ministerial.

This is a short, I hope illustrative, list of approaches to trade problems that are more worthy of attention. With the exception of the exchange rate problem, it is confined to legislation which could conceivably and usefully be enacted in this Congress. There is, however, another set of alternatives that needs to be addressed because it bears directly on the issue at hand. I refer to the relationship between this legislation and Section 201 of the Trade Act of 1974 and further to the relationship between section 201 and Article XIX of the GATT.

It has been almost two years since the International Trade Commission made the determination that imports were not a substantial cause of injury ot the U.S. automobile industry, and so it is open to the UAW or the industry to petition the ITC anew under Section 201. Notwithtanding the inherent difficulties of meeting the "substantial cause" test, it seems possible to us that the continued weakness of the U.S. industry and the ability of imports to capture an ever larger share of the U.S. market might now permit a different finding by the Commission. On the other hand, given the expense and the uncertainty of the outcome, industry reluctance to pursue this course again would be more than understandable.

These factors, however, need not be a bar to this course of action. Under the law, the President, the USTR, the Senate Finance Committee and the Ways and Means Committee all have the power to request an ITC investigation under Section 201 to determine whether automobiles are "being imported into the United States in such increased quantities as to be a subtantial cause of serious injury, or threat thereof, to the domestic industry. . ." In short, Congress, which can pass H.R. 5133 an also open a new ITC investigation.

Separately, if the Congress were to conclude that Section 201 as drafted makes it virtually impossible for an industry like the automobile industry to obtain relief, then perhaps Congress should consider amending the statute. GATT article XIX, which exists because the United States insisted upon it and which provides the analog in international law to Section 201, is much less restrictive than Section 201. One of the problems of the latter, of course, is that it appears to make import relief impossible in a recession since the recession will in most cases be seen as a greater cause of the industry's difficulties than imports. This particular version of Catch 22 seems to have been avoided in the GATT. A discussion of the famous hatters' fur case by Professor John Jackson, perhaps our foremost legal scholar on the GATT, suggests that the heart of the matter was resolved in 1951. The case involved a U.S. withdrawal of tariff concessions on hatters' fur from Czechoslovakia on the grounds that they caused or threatened serious injury to the U.S. industry. Professor Jackson writes:

"The GATT Working Party struggled with the question of serious injury and its cause. It examined data regarding quantities of imports and of United States production and employment in that industry, and found evidence of 'large and rapidly increasing . . . imports, while at the same time domestic production decreased or remained stationary.' This it concluded, was evidence of some weight in favor of the view that there was a threat of serious injury."

Common sense suggest that it is unwise to regard international trade as a competition in virtue. Certainly, it makes sense for the United States to try to improve the international trading system and to work to strengthen the legal framework within which most trade is conducted. It does not make sense, however, for domestic law to anticipate there improvements. In other words, the United States need not restrain itself on import relief beyond the requirements of the GATT.

Having said this much it is important to add that I am not today advocating either a Committee resolution directing the ITC to open a new 201 automobile case or changes in Section 201. I am suggesting that these options, which are consistent with U.S. international obligations, be thoroughly explored before the country adopts legislation such as H.R. 5133.

Earlier I said that the danger of retaliation could be exaggerated and throughout I have referred to the importance of keeping U.S. actions consistent with international law. There is a relationship between the two. It is a big gamble, but proponents of the legislation may be correct in arguing that the value of the U.S. market to Japan is such that Japan is unlikely to risk a rapid escalation of U.S. import restrictions by retaliating against domestic content legislation. On the other hand, Japan may feel that retaliation offers the only hope of containing this protectionist response to imports. In any event, the greater danger is that the legislation will undercut not only U.S. negotiating efforts in the GATT but efforts of those policy makers throughout the world who daily argue against protectionist solutions to economic problems. The international trading system can be likened to a city police force. The level of crime with which we are all familiar inspires a certain cynicism with respect to the efficacy of the police. But the conditions of our lives are far to be preferred to the chaos that results when there are no laws and no police.

We are well aware that GATT rules are frequently honored in the breach; that local content requirements are not unknown even in the OECD (Greece, Turkey, Spain and Australia have them); that France, Great Britain and Germany all have restrictions on automobile imports more severe than those which would be imposed by H.R. 5133; and that the Japanese automobile industry, clearly now the world's most competitive, was built up under conditions of almost 100% protection. Surely these measures flout the spirit if not the letter of the GATT, and just as surely the international system would be strengthened if these and similar measures in other countries and on other products could at the very least be notified to GATT, preferably under the provisions of a new safeguards code. NAM has consistently supported such a code, and we hope it remains high on the list of negotiating objectives for the GATT Ministerial. The suggestion that because the United States currently benefits, if that is the right term, from Japanese export restraint in automobiles renders us unable to push for a new code is in my view without merit. Certainly, though, enactment of H.R. 5133 would make such an effort by the United States seem quixotic if not arrogant.

A discussion of the relationship of this legislation to the trading system as a whole should not obscure the fact that the legislation is directed primarily at Japanese exports and understandably so. Many U.S. companies are distressed by the nature of our trading relationship with Japan. Indeed the NAM's International Trade Committee insisted on a paragraph expressing this viewpoint in their resolution of opposition to domestic content. This is the last paragraph of the resolution, and it reads as follows:

". . . , recognizing that domestic content legislation has been inspired in large measure by Japanese policies that have unjustifiably burdened U.S. commerce, the National Association of Manufacturers urges the Congress and Administration to take appropriate action with respect to these policies at the earliest possible moment."

In this connection, one of the more provocative commentaries on the unhappy relationship between Japanese policy and U.S. competitiveness now under consideration by the Administration is the Houdaille case. This case provides an illustration of an often overlooked element in Japanese industrial policy: that is the selective disregard of competition laws and the explicity encouragement of cartels. This is a petition for relief under Section 103 of the Revenue Act of 1971 filed last May by Houdaille Industries of Fort Lauderdale, Florida. Houdaille, an important machine tool builder that has seen the Japanese shares of critical U.S. markets rise dramatically in recent years, has asked the President to deny the investment tax credit for the purchase of numerically controlled (nc) machining centers and numerically controlled punching machines from Japan. Between 1976 and 1981, Japan's share of the U.S. nc machining center market went from 3.7 percent to over 50 percent, and in nc punching machines their share rose from 4.7 percent to 37.6 percent. Much of the petition is devoted to a description of the Japanese machine tool cartel and the manner in which it has been sheltered and nurtured by the Government of Japan. The issues raised by this petition, which NAM supports, are important for all of U.S. manufacturing. A common thread with the automobile industry, for example, is the question of whether industries that come to maturity under virtually full protection from international competition are to be accorded the same privileges in the marketplace as those which have had to deal with foreign competitors from their inception. The issue is an important one, especially now for America's high-technology industries. There is a temptation to assume that an industry or company that has had to battle world competition from its inception must be stronger than one that has grown up behind import barriers. That may be true in some cases but certainly not in all, and such an analysis overlooks the advantages of a secure market and assured cash flow that protection affords.

For the sake of this and other issues, we feel that the Houdaille case bears scrutiny by Congress as well as the Administration, and I should be grateful if the comments NAM submitted to the USTR on this matter could be included in the record as part of my testimony.

I have said as much as I have about the Houdaille case because it highlights our deep concern over several aspects of U.S. trade with Japan. These are serious problems which urgently need to be addressed. That does not mean, though, that the United States or U.S. industry can afford solutions, like H.R. 5133, which ignore and so jeopardize the benefits we receive from international trade.

Again I thank the Subcommittee for this opportunity to testify.

JULY 22, 1982.

DEAR MEMBER OF CONGRESS: Domestic content legislation is rapidly moving toward committee and floor consideration in both the House and the Senate. Accordingly, I should like to inform you of the views of American industry on this legislation. The National Association of Manufacturers is firmly opposed to the domestic content legislation, embodied on the House side in H.R. 5133 and on the Senate side in S. 2300. Both bills are entitled "The Fair Practices in Automotive Products Act".

NAM's opposition, expressed in the enclosed resolution, derives from the conclusion that the legislation is misguided for the following reasons:

Promoted as a job creating measure, the legislation would not by itself put a single man or woman to work, and in the long run would put far more U.S. jobs at risk than it encourages;

The vast majority of American companies do not want this legislation. They recognize that its primary effect would be to damage U.S. competitiveness rather than to expand U.S. markets; and

By forcing the United States to violate the General Agreement on Tariffs and Trade, the legislation would introduce a destabilizing element into the international trading system. The consequences of this, though difficult to foretell in detail, would almost certainly work to the detriment of the interests of the United States and to the world trading system as a whole.

For these reasons I urge you to reject domestic content legislation as inappropriate to the problems we face. In doing so, however, I would call your attention to the final paragraph of the enclosed resolution, in which we point out that "domestic content legislation has been inspired in large measure by Japanese policies that have unjustifiably burdened U.S. commerce." Domestic content legislation should be voted down, but the pursuit and implementation of an effective strategy for dealing with the Japanese challenge remains of paramount importance.

Sincerely,

LAWRENCE A. FOX.

RESOLUTION ON DOMESTIC CONTENT LEGISLATION

Whereas the domestic content legislation now pending before the House and Senate (H.R. 5133 and S. 2300 respectively) has implications for all manufacturing sectors and for the conduct of U.S. economic policy both domestically and internationally;

Whereas the National Association of Manufacturers believes the interests of the United States can best be served by strengthening competitive market forces and furthering the rule of law in international trade;

Whereas these bills, by establishing quantitative regulation for the purpose of affording protection to U.S. automotive production, would involve the United States in a serious violation of its obligations under the General Agreement on Tariffs and Trade and would cripple U.S. Government efforts to remove foreign trade barriers, including domestic content requirements, that undermine the international trading system;

Whereas the proposed legislation may prove self-defeating by encouraging an inefficient allocation of resources and retardng the U.S. automobile industry's adjustment to international competition;

Whereas this legislation is ill-conceived in that it would put at risk more jobs than it could reasonably be expected to create;

Whereas the legislation is ill-timed in that there are still administrative remedies open to the automobile industry, e.g., further action under Section 201 of the Trade Act of 1974;

Whereas Congress has yet to consider amendments to Section 201 that would increase the likelihood of relief being granted under Section 201 without violation of the international obligations of the United States;

Whereas the domestic content legislation is inappropriate in that it does not address the underlying causes of the trade friction in the U.S.-Japan commercial relationship, including an undervalued yen, protected markets, barriers to investment, and Japanese commercial policies that adversely affect U.S. industry; and

Whereas the legislation ignores options open to the United States under international trade law:

The National Association of Manufacturers opposes the aforementioned domestic content legislation. We urge the Congress and the Administration to reject it as inappropriate to the problems of U.S. industry, including the automobile industry, and injurious to the pursuit of international economic policies better calculated to preserve and strengthen the U.S. industrial base;

Recognizing that domestic content legislation has been inspired in large measure by Japanese policies that have unjustifiably burdened U.S. commerce, the National Association of Manufacturers urges the Congress and Administration to take appropriate action with respect to these policies at the earliest possible moment.

Adopted by the NAM International Trade Policy Committee, July 15, 1982.

NATIONAL ASSOCIATION OF MANUFACTURERS,
Washington, D.C., July 14, 1982.

Hon. DONALD T. REGAN,
Secretary of the Treasury,
U.S. Department of the Treasury, Washington, D.C.

DEAR MR. SECRETARY: In January 1982, the National Association of Manufacturers established a Task Force on U.S.-Japan Commercial Relations. The Task Force membership is broadly representative of U.S. industry, as well as major banks and export-related service industries. This Task Force is now in the process of working on a number of trade, financial and investment issues. The broad outlines of the Task Force's work are set in a resolution passed by NAM's Board of Directors on March 17, 1982 (copy enclosed). NAM's objectives relate to the resolution of immediate as well as longer range problems of a systemic nature in our commercial relations with Japan.

One of the most critical concerns of the Task Force is the exchange rate between the U.S. dollar and the Japanese yen. We are, of course, aware of the Administration's general concern about the consequences for U.S. industry of the undervalued yen, but regret that no practical steps have been taken or proposed to deal with the problem. The manufacturing community is intensely concerned about the undervalued yen in both the immediate and longer term.

In the short term, U.S. industry is losing market shares at home and abroad. The yen has depreciated since 1980 by approximately 25 percent—from about 200 to the dollar to the 250 level at present. The meaning of this depreciation in competitive terms is dramatic: While Detroit has been seeking to close a $1500 gap between U.S. and Japanese built cars the depreciating yen has in fact given Japan an additional $1200 to $1500 advantage during this time.

In the long term, new investment by American industry is not taking place because in many instances this investment would be uneconomic in light of the inordinately competitive price of Japanese goods resulting from an undervalued yen. To the extent that the Japanese challenge represents the free play of economic forces, it can be viewed as a natural development and should not be interfered with. We have become increasingly concerned, however, that the American response to the Japanese challenge is being distorted and undermined by a gross misalignment between the U.S. dollar and the Japanese yen.

Our concern is not unique. The European Community in its formal case against Japan under Article XXXIII of the General Agreement on Tariffs and Trade (GATT) referred to the yen as "a sui generis currency", which was "in certain respects tightly controlled and which has been insulated from the outside world". The Community noted that "the yen does not play a role internationally commensurate with the strength of the Japanese economy". Reference is made to the European view, not so much to buttress our arguments, but to indicate the necessity for international cooperative action in dealing with an international trade and financial problem which cannot be left only to Japanese authorities to deal with and which under present circumstances defies a straight-forward market solution.

Today the yen stands at more than 250 to the dollar—a rate not much higher than in March 1973, when generalized currency floating was established. Indeed, if we utilize the well-known Morgan Guaranty real effective exchange rate index, we find that the dollar is now 16 percent higher in value than in 1973, while the yen is about 15 percent lower, as measured on a multilateral, trade-weighted basis. During this interval the volume of Japanese exports has grown over twice as fast annually as U.S. exports (8 percent to 4 percent). At the same time, the annual price increase for Japanese manufactured exports, in national currency terms, has been five points per year lower than the equivalent U.S. figure (7 percent to 12 percent). These and other fundamental underlying economic conditions—such as current account balances, official reserves, trade balances, productivity growth, and wholesale price increases—indicate that the nominal value of the yen should have risen much more substantially over this time period against the dollar; instead we have seen a fairly steady drop in the yen since its peak of 180 in 1978.

The interest rate differential between the U.S. and Japanese domestic credit markets is undoubtedly an important reason for the misalignment of the dollar and yen during the last few years. As you know, NAM fully supports the Administration's concern regarding high U.S. rates. However, we feel that reduction in our interest rates will help relieve only part of the exchange rate problem between the dollar and the yen. We are inclined to believe that a good part of the problem will persist despite interest rate changes because the Japanese have to an important degree cut their domestic credit markets off from the influences of the international financial markets.

Japan's low domestic interest rates, which are less than half American and European rates, obviously reflect the interplay of a number of factors, including a superior performance in maintaining a low level of inflation since the 1973–74 oil crisis. It is also important, however, to realize that Japan's domestic credit system relies in many respects as much on quantitative restrictions and official guidance as it does on price in allocating credit to priority sectors of the economy. Consequently, interest rates can remain relatively low and provide a reliable and cheap source of domestic as well as export credit to major Japanese exporters of manufactured goods.

It is not hard to appreciate the current desire of the Japanese government to maintain low interest rates in light of relatively poor domestic economic performance and the need to hold down the cost of financing their large budget deficits. Yet, to what extent are these low rates also enabling Japan to "solve" its domestic economic problems by exporting them through an undervalued currency? Estimates have been made that two-thirds of Japan's almost 3% real GNP growth for the fiscal year ending in March 1982 came from exports. It is hardly unreasonable to ask how much longer countries with no real growth and with unemployment reaching toward double digit figures can tolerate this situation, especially in light of a 2% unemployment rate in Japan. Does it make much difference if a country pursues a "beggar-thy-neighbor" policy by means of trade protection or domestic monetary and credit policies?

You will appreciate that I am not suggesting that Japan is now actively intervening in foreign exchange markets to bring about a low price for the yen, although Japan has done this in the past. Quite the opposite is the case—since the misalignment at this point is so notorious, causing Japanese officials to be quite defensive respecting the undue trade advantages conferred on Japanese goods in export markets as well as in the Japanese home market. The most "successful" Japanese exchange market intervention was in the mid 1970's when massive intervention halted the appreciation of the yen. Japanese intervention in January 1981 appears to have halted yen appreciation at that time and perhaps help to set the stage for the current weak yen. Lisle Widman, former Deputy Assistant Secretary of the Treasury for International Monetary Affairs, observes:

"Bank of Japan officials acknowledge that in January 1981 they did intervene to stop the appreciation of the yen when it moved back above 200. Whether they did so because they had concluded that they should protect their trade position by avoiding further appreciation or simply because the rapidity with which the rate was moving created a disorderly market we will never know. Japan had been running a deficit in its current account balance in 1980 and the country was still very concerned about its ability to finance oil imports. I suspect the gut judgement of Japanese officialdom is that a 200 to 220 rate would be best for Japan. Nevertheless, Japanese officials maintain that the intervention was not intended to alter the long-term trend."

Our view is that a good deal of the undervaluation of the yen basically results not from direct exchange rate intervention but from Japanese policies in respect to their domestic credit markets. To the extent that these policies maintain the trade advantages of an undervalued currency, they are a fair target for attention in the International Monetary Fund under Article IV of the IMF Articles of Agreement. This prohibits signatories from manipulating their currencies or taking other action to "gain an unfair competitive advantage" in trade. Additionally Article IV calls for IMF surveillance over exchange rate policies for a number or reasons, including ". . . behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long term capital movements."

We were pleased to see that agreement was reached at the recent Versailles Summit on an improved consultation process involving the IMF and the major industrial countries, as well as the initiation of an IMF study of the efficacy of foreign exchange intervention. We would certainly support Administration efforts to use this consultation process to the fullest in examining the interaction between the Japanese domestic credit markets and the continued undervaluation of the yen. We would also suggest a careful examination of Japanese currency intervention in the 1970's which may have laid the groundwork for the present undervaluation of the yen.

I would conclude by expressing the opinion that the persistence of a seriously undervalued yen for the next several years obviously presents serious obstacles to the modernization of the American industrial base and to the general American economy. The Administration's successful efforts to resist protectionism in this country and abroad has the full support of the National Association of Manufacturers. Perhaps no greater step to assure the continuation of open markets in the U.S. and around the world could be taken than to help bring about promptly a major appreciation of the yen. It is likely that high U.S. interest rates may persist for some time and lower rates, once achieved, may be only of limited value in the context of the yen-dollar exchange rate. We therefore, urge consideration of policies that work toward the improvement of the operation of the international monetary system, including the requirement that major trading countries maintain a reasonable foreign exchange value for their national currencies reflecting underlying economic forces.

To date the Treasury has given no indication publicly that the yen-dollar exchange rate is of concern to the U.S. government. To relate how significant this issue is to the revitalization of American industry, I would be pleased to call on you with members of NAM's Board of Directors to elaborate business views on the importance of this critical issue in industry's investment decisions to become more competitive in U.S. and foreign markets. We hope your schedule will permit such a meeting in the near future.

Sincerely,

SANDY TROWBRIDGE.

COMMENTS OF THE NATIONAL ASSOCIATION OF MANUFACTURERS ON THE PETITION OF MAY 3, 1982, BY HOUDAILLE INDUSTRIES

The petition for withdrawal of investment tax credits under Section 103 of the Revenue Act of 1971, which was filed by Houdaille Industries, Inc. on May 3 is formally very narrowly focused. It requested denial of this credit for two products only: numerically controlled (NC) machining centers and numerically controlled punching machines from Japan.

In general, it is not the poicy of the National Association of Manufacturers to comment on individual import cases. The Houdaille petition, however, is in our view a landmark case with board implications for U.S.-Japan commerical relations, for U.S. trade policy, and for U.S. industry. If the case as set forth by the petitioner is substantially correct, and we have no reason to doubt that it is, then in our view it is essential that the President provide adequate relief. Not to do so could jeopardize the industrial revitalization that is the bedrock of America's future.

The Comptroller General's 1979 report,"United States-Japan Trade: Issues and Problems," notes important similarities between the machine tool industries in the two countries. They are relatively small in each country and highly fragmented. In 1975, for example, there were only ten U.S. machine tool firms with more than 1,000 employees but over one thousand plants with forty-nine employees or less. Comparable figures for Japan show 35 plants with 300 employees or more and 1,480 plants with 49 or less.

Two other similarities should also be noted. First, machine tools have an economic importance beyond their dollar value as they are critical to a variety of industries from aircraft to farm machinery. Second, the industries are strong ones in both countries. In 1981, the United States was the world's largest producer with sales of $5.15 billion and Japan the second largest with sales of $4.86 billion. Though the U.S. has had a negative balance of trade in machine tools since 1978, it is still an important exporter, and in 1981 sold more than $1 billion in machine tools abroad. thus, in comparing the two industries, one is comparing strengths of the two economies, not a strength of one and a weakness of the other.

The starting point for the petitioner is the phenomenal and for it painful increase in Japan's share of the U.S. market for the products at issue. It notes that in 1976 Japan enjoyed 3.7 percent of the U.S. market for (NC) machining centers. By 1981 Japan had 50.1 percent of the machining center market. The increase in Japan's share of the U.S. market for NC punching machines was only slightly less dramatic, going from 4.7 percent in 1976 to 37.6 percent in 1981.

The allegation is that this was achieved by means of a government sponsored cartel. The petitioner might as well have said it was achieved as a result of Japanese industrial policy. Presumably it did not because a foreign industrial policy per se provides no explicit basis for a petition under U.S. law, but one that involves "tolerance of international cartels" does. It is, however precisely because the petitioner has demonstrated the breadth and power of Japanses industrial policy that his case commands the attention of anyone concerned about preserving and strengthening the U.S. industrial base. Japan is, of course, not unique in having an industrial policy/or policies. Certainly, though, those policies are uniquely successful, with consequences of some importance for U.S. industry in American, Japanese, and third country markets. Their rationale was well explained in 1970 by a minister for Japan's Ministry of International Trade and Industry speaking before the OECD Industry Committee:

"After the war . . . Japan's first exports consisted of such things as toys and other miscellaneous merchandise and low-quality textile products. Should Japan have entrusted its future in the theory of comparative advantages in these industries characterized by intensive use of labor? . . . If the Japanese economy had adopted the simple doctrine of free trade and had chosen to specialize in this kind of industry, it would have almost permanently been unable to break away from the Asian pattern of stagnation and proverty. . .

"The Ministry of International Trade and Industry decided to establish in Japan industries which require intensive employment of capital and technology, industries that in consideration of comparative costs of production should not be the most inappropriate for Japan, industries such as steel, oil refining, petrochemicals, automobiles, aircraft, and electronics, including electronic computers. From a shortrun viewpoint, encouragement of such industries would seem to conflict with economic rationalism. But from a long-range viewpoint these are precisely the industries of which income elasticity of demand is high, technological progress rapid, and labor productivity rises fast."

Cartels provide a means by which the Japanese Government can identify and work with an industry. They are at the heart of Japanese industrial policy. It is our understanding that Japan has informed the OECD that it formally recognizes 469 cartels. Admittedly, many of these are small concerns with little impact on international trade. The figure does not include a number of cartels of major Japanese industries, like the machine tool industry, that do have such an impact. Clearly collections of firms subject not only to regulation but to direction from central authority, whether it be the Government of Japan through its administrative advice procedure or their trade associations, are in essence cartels. The petitioner identifies the cartel of interest to him as one made up of the largely overlapping memberships of the Japan Machinery Exporters Association and the Japan Machine Tool Builders Association. He traces the Japanese government's involvement with this cartel from the First Extraordinary Measures Laws of 1956 through the successors of that legislation, namely the Extraordinary Measures Law for Promotion of Specific Electronic Industries and Specific Machinery Industries Law No. 17 of 1971 and the Extraordinary Measures Law for Promotion of Specific Machinery and Information Industries, Law No. 84, of 1978. These laws, he notes, made possible domestic anticompetitive relationships within the industry and the skewing of orders to selected firms in the name of rationalization. According to the petition, "there appears to be no risk (to the cartel) of prosecution (under Japan's antitrust laws) as long as (it) complies with MITI guidance, regardless of how anticompetitive that guidance may be."

Further, the report is replete with examples of other, more direct forms of government involvement and assistance, including the following:

(1) Import protection. The petition alleges that for a considerable period Japan did not permit the importation of machine tools for which there were Japanese equivalents. This protection served to ensure high domestic demand and thus lower unit costs. Further, the "monopoly profits" that flowed to Japanese producers as a result of these restrictions strengthened their ability to price exports more competitively than would otherwise have been the case.

(2) Subsidization. The petition refers, inter alia, to the fact that in the '50s, favored industries, including the machine tool industry, were licensed to import sugar, the value of the license being assured by the government's quota on sugar imports. Additionally, the attorney for the petitioner has informed us that between 1954 and 1981 the machine tool industry received approximately $1.46 billion in the form of receipts from national bicycle races, these funds to be used for industry rationalization, export promotion and research development.

(3) Taxation. Several provisions of Japanese tax law explicitly favor the machine tool industry.

(4) Finance. Japanese banks have provided significant loans to the industry to enable it to sell deferred payment terms to the domestic Japanese market, an option not open to American and other foreign competitors in Japan.

These are, of course only elements of the Japanese industrial policy with respect to machine tools, not an exhaustive description. It might appear that some of these practices could provide a basis for action against Japanese machine tool imports other than that taken and requested by the petitioner. In our view, the petitioner has done a service to American industry by focusing on the relationship of these practices to a cartel. Such a focus permits one to consider the problem not in terms of one or another practice which may or may not be a specific offense under U.S. or international law but in terms of the unique challenge to American industry of Japanese industrial policy. United States law may not be fully adequate to deal with foreign industrial policies that hurt U.S. companies and U.S. industry; it is not, however, bereft of remedies.

Because of the Houdaille petitition, it is no longer possible to argue that advanced and healthy U.S. industrials are immune from the injurious effects of foreign industrial policies. It is, therefore, important to demonstrate that where the danger of such policies is perceived, it will be addressed. Accordingly, the National Association of Manufacturers urges the Administration to take effective action with respect to NC machining centers and NC punching machines from Japan if it concludes that the allegations of the Houdaille petition are substantially correct.

LAWRENCE A. FOX,
Vice President for International Economic Affairs,
National Association of Manufacturers.

STATEMENT OF LAWRENCE A. FOX, VICE PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS, ON THE EXPORT-IMPORT BANK RESTRUCTURING ACT OF 1982

Mr. Chairman and members of the Subcommittee, I am Lawrence A. Fox, Vice President for International Economic Affairs of the National Association of Manufacturers. I very much appreciate the invitation to appear today before the Subcommittee to present NAM's views on U.S. export financing practices and how some of the problems in our official system might be addressed by S. 2600—the "Export-Import Bank Restructuring Act of 1982."

The 11,000 members of the NAM account for approximately 80 percent of U.S. industrial output and 85 percent of U.S. industrial employment. Because the lion's share of U.S. exports are shipped by the larger American companies, almost all of whom are NAM members, it is a fair guess that our members account for an even greater portion of U.S. manufactured exports than of U.S. industrial production. In practical terms, this means that our concern for U.S. international competitiveness is second only to our concern for the strength of the U.S. industrial base. In fact, the two cannot be separated.

In trying to arrange competitive financing for sales in international markets, the U.S. manufacturing industry during the past half dozen years has been increasingly hard pressed by the combination of very high domestic interest rates and extremely aggressive export financing practices of other nations. Yet, even in these circumstances, it has been virtually impossible to obtain adequate and reliable funding for the Export-Import Bank under the current procedures for handling the Bank's annual budget. The "Export-Import Bank Restructuring Act of 1982" would help resolve this problem. I am, therefore, pleased to have this opportunity to provide you with our comments on this legislation.

IMPORTANCE OF EXPORT FINANCING

The importance of export financing to the sale of manufactured goods in international markets is not hard to understand in the case of major projects and big ticket items such as capital goods. Recent developments in the U.S. housing market are instructive relative to the importance of the cost of credit. We have seen very clearly over the past two years in our housing market that home buyers will not make major, long-term purchases unless reasonable financing is available. Such financing, or course, has not been available and the housing industry is in a severe slump.

The role credit plays in the health of the U.S. housing industry is similar to the role it plays in the health of U.S. manufactured exports. Other nations have long understood this fundamental aspect of trade competition. They have established financial structures in their national economies which are as supportive of their export industries as our financial system has been of our housing industry over the past 30 years. In 1980, for example, the major industrial nations authorized over $160 billion for export insurance, guarantees, and direct credits. Japan authorized $56 billion in official export finance, the United Kingdom $43 billion, France $32 billion. The U.S. level was $12.6 billion, the lowest of any of the major trading countries. As seen in chart 1, 30–40 percent of the total exports of Japan, the U.K. and France were assisted by official export credits of one type or another. The corresponding figure for the U.S. is about 5½ percent.

The aggressive export financing practices of other nations in large measure reflect their response—catch-up ball if you wish—to the advantages which the U.S. export financing system once conveyed upon U.S. exports. Up until the mid-1970s, our export financing system could draw on our commercial markets with their relatively low rates of interest and favorable terms to supply most of the competitive financing needs of U.S. manufacturers. The Export-Import Bank was then available to support those longer term projects in which competitive financing was not available in the private commercial markets.

CHART 1

OFFICIAL EXPORT SUPPORT AUTHORIZED

[In billions of dollars]

	1978	1979	1980
Canada	4.0	3.5	(1)
France	30.7	32.2	31.6
Germany	15.0	14.5	14.5
Italy	8.7	8.0	(1)
Japan	31.8	39.4	56.1
United Kingdom	35.1	33.4	42.9
United States	7.4	9.5	12.6

[1] Information not available.

PERCENTAGE OF TOTAL EXPORTS SUPPORTED BY OFFICIAL FINANCING

[In percent]

	1979	1980
Canada	6.3	(1)
France	32.0	27.2
Germany	8.4	7.5
Italy	11.1	(1)
Japan	38.3	44.3
United Kingdom	38.7	39.0
United States	5.2	5.7

[1] Information not available.

While other nations were working in the 1960s and 1970s to establish competitive export financing mechanisms to support their exports, events were working to weaken the advantages once enjoyed by the U.S. export financing system. U.S. commercial interest rates climbed above the rates of our principal competitors. With higher rates and sharper fluctuations in these rates U.S. commercial banks were less able to meet the demand for export credits at fixed rates, especially for large projects. At this time European and Japanese efforts to overcome the balance of payments consequences of the higher costs of oil brought into being new export credit techniques and increased exports credit subsidies to fuel their export expansion drives.

As a consequence of these developments, large U.S. companies in order to compete in international markets found alternatives to exporting goods from the U.S., often sourcing orders out of foreign plants with credits offered by foreign banks and government institutions.

There are many examples of lost export business for U.S. companies due to noncompetitive export credit terms. For example, a recent survey by the Machinery and Allied Products Institute indicates that many U.S. companies routinely divert export orders to foreign affiliates in order to obtain competitive export financing. Their survey, which covered only 39 companies, identified $386 million in export orders that were shifted to foreign affiliates in 1981 because the financing available abroad was more attractive. The problem is so endemic and the response so routine that the study almost certainly understates the problem even for the firms covered. Even so $386 million, viewed as the tip of the iceberg, is significant. Commerce Department estimates of the ratio of export values to jobs indicates that this lost business represents about 13,000 lost jobs for this country.

In some cases, U.S. manufacturers try to compensate for the lack of official support in this country by arranging "creative" financing deals with commercial banks. This can be a tough road to follow when you are trying to compete with the treasuries of our major trade competitors—a fact illustrated by a recent experience of American Sign and Indicator Corporation in Brazil. I quote from a letter sent to us by American Sign and Indicator describing their particular case:

"Our competition was Italy's soft loan at 7.5 percent on $65 million in financing. We offered 7 percent, built the interest subsidy into the equipment price, matched the other terms, came in with a final bid of almost $1 million less than our Italian competitor, and still lost the job. The reason given by the Brazilians was that it was easier for them to consummate a loan of $65 million and incorporate the purchase of other Italian equipment versus two separate loans."

Mr. Chairman, the case example provided to us by American Sign and Indicator is an excellent example of how an uncompetitive official financing system hurts U.S. manufacturers and workers. (I have attached to my testimony a copy of the complete letter sent to us by American Sign.)

The NAM has regularly surveyed our member companies concerning the competitiveness of official financing systems. The results are always the same. The U.S. ranks behind other major industrial nations such as France, Britain, Japan, and Germany; sometimes we areahead of Italy. The Eximbank's own surveys over the years have produced the same results.

The United States Government, which historically has tended to underestimate the importance of exports, has not responded in any fundamental manner to these new realities of international competition. It still does not seem to realize that 30 percent of the net job increase in the private sector between 1977-80 came from manufactured exports and that the continued health of this critical sector depends upon maintenance of a competitive export financing system.

MISUNDERSTANDING OF WHAT EXIMBANK "COSTS"

There are a number of reasons for our failure to develop a competitive export financing system. One reason is a misunderstanding about the cost to the U.S. taxpayer of providing the Eximbank with adequate financing. The Eximbank ordinarily receives no direct tax dollars from the U.S. Congress to cover the loans and guarantees it makes or the costs incurred in implementing its programs. Instead of appropriating funds for the Eximbank, Congress establishes a ceiling on the level of program activity that the Bank may engage in for each fiscal year. The Bank then borrows the necessary funds from the Federal Financing Bank (FFB), which is an agency of the U.S. Treasury. In Eximbank's case, it borrows indirectly from the credit markets through the FFB (which borrows in the capital markets for several federal government agencies).

The Eximbank generates resources to repay its borrowings through loan repayments, interest on outstanding loans, commitment fees and insurance premiums. So far the Bank has been able to absorb the cost of its borrowings, repay the FFB with interest, pay the Treasury Department more than $1 billion in dividends and triple its initial capitalization of $1 billion. In short, the Eximbank operates similarly to a commercial bank. It makes loans, and charges interest and fees for services. As the loans are repaid and fees collected, the Bank repays its own borrowings and the interest due on these borrowings, pays administrative costs and dividends, and builds up reserves.

Although each year Congress sets a limit on the amount of loans and guarantees that the Eximbank is allowed to issue, net outlays by the Bank for its programs are much lower than the authorization figures. There are two reasons that explain this obviously interesting point.

First, unless a claim is made against the Bank, there is no budget outlay for guarantee and insurance programs, which account for well over one-half of the annual authorization for the Eximbank. In the Bank's almost 50 years of existence, the default rate on its guarantee program has been only three-tenths of 1 percent of all guarantees issued.

Second, authorizations are made annually, while outlays flow from these authorizations over a period of years. Thus, while the direct and discount loan progams are included at full value in the budget authority figures and the Bank usually authorizes up to its limit, net outlays (what must be financed by borrowing from the FFB) are much smaller. To measure actual outlays, the schedule of disbursements must be taken into account, with loan repayments and interest payments subtracted from total expenditures.

Chart 2 illustrates how this process works using fiscal year (FY) 1981 as an example. Prior year commitments on direct loans payable in fiscal year 1981 of $2.73 billion, current and prior year authorizations for discount loans of $2.7 billion, and disbursements on new direct loans of $.51 billion required total loan disbursements of $3.51 billion. Operating costs, interest payments, administrative costs and net claims paid out were $1.23 billion.

These obligations were offset by $1.47 billion in loan principal repayments, $1.6 billion in interest charges and $40 million in guarantees, insurance premiums and fees. Total disbursements and costs, less offsetting payments, equaled net outlays of $2.07 billion. So in fiscal year 1981 only $2.07 billion out of authorizations of $12.8 billion was borrowed from the FFB to implement Eximbank's program for that year. Thus the Eximbank's program impact on the credit markets is marginal.

A summary of Eximbank net outlays for fiscal years 1977 through 1981 is found in chart 3. As the chart indicates, from 1977 through 1981 total program authorizations of $47.8 billion required net outlays of $4.27 billion.

COMMENTS ON "EXPORT-IMPORT RESTRUCTURING ACT OF 1982"

I hope I have succeeded in explaining how Eximbank's budget works because it is important to understand that the figures which appear in the Federal budget for the Bank represent loan disbursals and not grants. The net outlay figure of $4.27 billion mentioned above is going to bre repaid with interest. Interest payments in FY 1981 amounted to over $1 billion (see Chart 2). This is hardly true of other items in the Federal budget. Yet, the current budget process makes no distinction between a loan disbursal by Eximbank and an outright expenditure by some other government agency.

The "Export-Import Restructuring Act of 1982" (S. 2600) tries to resolve this inconsistency in the budget process by removing the Bank's net outlays from the appropriation budget while still requiring the Bank's overall program levels to go through the annual authorization an appropriation process.

Chart 2

Eximbank Impact on FY 81 Federal Budget
(in $ billion)

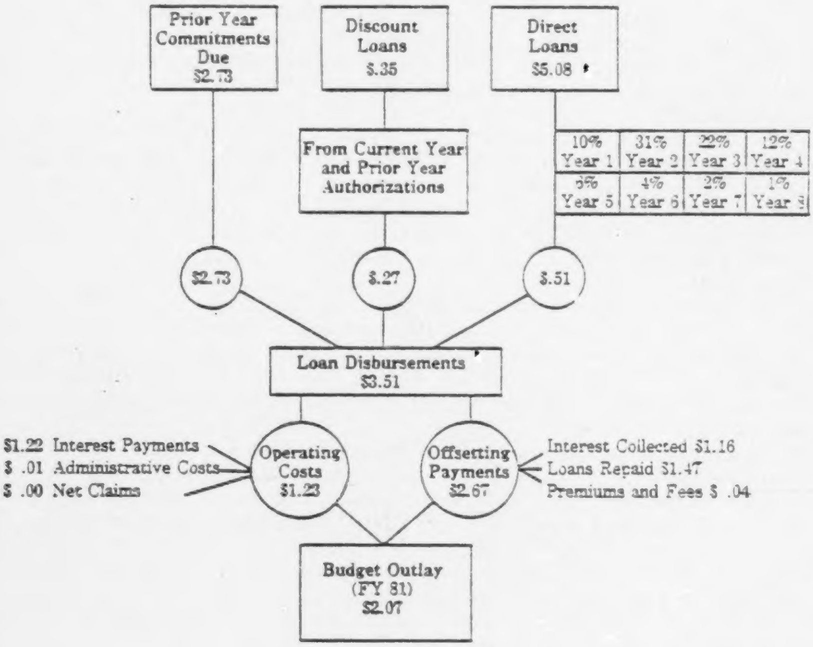

Prior Year Commitments Due $2.73
Discount Loans $.35
Direct Loans $5.08
From Current Year and Prior Year Authorizations
10% Year 1
31% Year 2
22% Year 3
12% Year 4
5% Year 5
4% Year 6
2% Year 7
1% Year 8
$2.73
$.27
$.51
Loan Disbursements $3.51
$1.22 Interest Payments
$ .01 Administrative Costs
$ .00 Net Claims
Operating Costs $1.23
Offsetting Payments $2.67
Interest Collected $1.16
Loans Repaid $1.47
Premiums and Fees $ .04
Budget Outlay (FY 81) $2.07

Chart 3

Eximbank Export Support and Its Impact on the Federal Budget
(in $ billion)

	1977	1978	1979	1980	1981	Total
Total Program Authorizations (includes all loans, guarantees and insurance)	5.6	7.4	9.5	12.5	12.8	47.8
Net Outlays	.3	−(.1)	.2	1.8	2.07	4.27

BEST COPY AVAILABLE

Let me be very clear that we are not in favor of taking the Eximbank "off budget" and out of control of Congress. Ideally, the best long term solution to dealing with the Eximbank might be its inclusion in a binding Federal credit budget. NAM's Vice President for Tax and Fiscal Policy, Paul Huard, testified on this subject before the Task Force on Credit of the Budget Committee. In his testimony Mr. Huard set forth a number of questions which we feels must be asked in evaluating our various Federal credit programs:

Does the original need for the program still exist?

Is the program cost effective or are there more moderate methods available to achieve the same goal?

How much of a federal subsidy is included in the interest rate set for the program?

We specifically state that "one Federal credit program which NAM feels passes the test set forth in the preceding questions is the Export-Import Bank".

The development of a binding Federal credit budget is hardly around the corner. Between now and then a lot of manufacturing business and employment is going to be lost unless we establish a competitive export financing system. It is undoubtful that we are ever going to do so, however, if we are saddled with a budget process in which we seem to mix up assets and liabilities. Under such a system, every time we try to expand Eximbank, and hence increase its net outlays, a red light is going to come on warning about increasing the budget deficit. It is important to pay attention to such red lights. But in this case, the light is a malfunctioning signal leading to actions not justified by underlying conditions. The signal is mixing expenditures, which are never going to be repaid, with loan disbursals, which are repaid with interest.

The change which S. 2600 would make in the budgetary treatment of Eximbank is the critical aspect of the legislation. There are, of course, other provisions in this legislation on which I would like to briefly comment:

(1) "War chest" funding.—NAM for the past two years has supported the so-called "war chest" bills which would provide Eximbank with special funding to counter the extraordinary financing practices of other nations. We continue to support such legislation as a necessary step in protecting U.S. interests as long as such protection cannot be secured through international agreements. We, therefore, endorse the "war chest" provision of S. 2600.

Members of NAM's Export Financing Task Force, however, have expressed concern over the proposal contained in S. 2600 for financing of agricultural exports through an Eximbank "war chest" fund. We do not question the need for such financing, but we do wonder whether Eximbank is the proper place to handle it.

(2) Board of Directors.—As for the proposal in S. 2600 to stagger the terms of the Eximbank's Board of Directors, we have no objections to such a change. Continuity in the Bank's leadership makes good sense.

(3) Reauthorization of the Eximbank.—We do, of course, support the provision in S. 2600 extending the Bank's charter until September 30, 1988.

ADMINISTRATION POLICIES TOWARD EXPORT FINANCING

We are under no illusions that S. 2600 will solve all the problems of funding the Eximbank. The legislation really just recognizes the realities of the Bank's impact on the Federal budget and makes adjustments accordingly. It will not provide American exporters with a stronger Eximbank if the Administration is determined not to have one.

In this regard, we find encouraging a statement by Eximbank President, William H. Draper, contained in the Bank's latest annual report: "The time is past when American companies can limit their sales to the domestic market and the time may never come when they can rely on the private sector to meet all of their needs for competitive export financing." This statement not only recognizes the vital link between international trade and domestic economic growth, but it also acknowledges the important role Eximbank has in ensuring a competitive U.S. export financing system. This seems to be a more realistic assessment of what it takes to compete in world markets than we heard from top Administration officials one year ago. In parcelling out budget cuts last year, reducing Eximbank's budget was seen as business' sacrifice along with everyone else. What did not seem to be appreciated in such a policy was that the success of our domestic industrial revitalization program was linked in many important ways to the success of U.S. companies in international markets.

We, therefore, applaud the more realistic note which Mr. Draper has introduced into the Administration's position on the Eximbank. We hope that this will lead to policy actions to strengthen the Bank. Specifically, we wonder how competitive the Eximbank can be when it continues to charge 2% user fee on new business. The maintenance of this fee would seem to be clear signal that the Administration still attaches greater importance to making the Bank a self-sustaining institution rather than a competitive one. As this Subcommittee knows, the latter goal is mandated by Congress in the Eximbank statutes; the former is not.

The competitive posture of the Bank is further eroded by the fact that it will apparently not use its entire budget authority for FY 1982. The worldwide recession has something to do with this fact. So does the 2% user fee and other steps taken by the Eximbank's management to reduce demand for its services. The Bank has simply discouraged U.S. business from applying for loans by charging higher rates than could be obtained abroad, and financed a smaller portion of the total transaction price.

As with past Administrations, this Administration has put a great deal of weight on international credit negotiations. As this Subcommittee is well aware, there has been a succession of international negotiations on export credit, but the "credit war" continues. This may be partly due to the fact that the perception of the United States as a "paper tiger" has yet to be seriously challenged, much less disproven. At the 1980 Venice Summit, for example, the participants agreed to, "strengthen the international arrangement on export credits with a view to reaching a mutually acceptable solution covering all aspects of the arrangements by December, 1980."

Then in 1981 the Ottawa summit leaders agreed to, "endorse efforts to reach agreement by the end of this year on reducing subsidy elements in official export credit schemes."

In the 1982 Versailles summit it was acknowledged that there was a "need for commerical prudence in limiting export credit" to the Soviet Union.

NAM has recently published an article on the history of the international credit negotiations in a recent issue of our International Economic Report. A copy of this article is attached to our testimony.

To be sure, some progress has been made in these negotiations but it is progress that has done little to foster U.S. economic interests. These interests must be achieved only by means of a two-path approach: providing the Eximbank with adequate funding *and* negotiating a sound and effective international agreement. I personally doubt that we can achieve the latter unless it is clear that we have accomplished the former.

Mr. Chairman, I want to thank you for allowing me to testify today on the U.S. export financing system. I will, of course, be glad to answer questions.

Chairman GIBBONS. Thank you, sir, and we will receive a copy of that petition to put in the record.

Now, we will hear from the U.S. Chamber of Commerce.

STATEMENT OF FREDERICK W. STOKELD, DIRECTOR, INTERNATIONAL ECONOMIC POLICY, U.S. CHAMBER OF COMMERCE, ACCOMPANIED BY JAMES P. ROONEY, CHAIRMAN, THE ASIA-PACIFIC COUNCIL OF AMERICAN CHAMBERS OF COMMERCE

Mr. STOKELD. Thank you, Mr. Chairman.

With your permission, I would like our written statement to be entered into the record.

Chairman GIBBONS. Yes, sir, without objection, it will be.

Mr. STOKELD. I will make a brief three-point summary of our statement.

With me is James P. Rooney. He has traveled all the way from Bangkok to be with us today, and I will defer as much time as possible to Mr. Rooney, who has some comments on practical considerations of the legislation and on some of the underlying considerations that the legislation addresses.

Chairman GIBBONS. Certainly.

Mr. STOKELD. To begin, Mr. Chairman, we share entirely the concern of the bill's supporters with the unemployment situation in the automotive industry.

Where we differ, and that also covers the underlying trends in the United States and world economies that have produced the problem, is on the best way to turn the situation around. We believe that domestic content, even in its mildest forms, is an option of the last resort.

In the versions before the subcommittee, its main drawback, as we see it, is that it does not deal with the prime cause of the industry's problems, which is weak consumer demand.

Unfortunately, economic recovery is a slow road to travel. The fact remains it is the only one that goes anywhere. With economic recovery, there is no need for domestic content, and without it, it is even more moot.

The road to economic recovery involves more than reducing interest rates.

A second and related consideration is that the bill does not reflect the efforts of the automotive industry to improve its competitiveness. It implies that we cannot compete effectively with imports.

We believe the opposite is true.

As the chairman pointed out earlier this afternoon, even Japan has short- and long-term problems that we sometimes overlook in addressing the situation of Japanese-United States competition.

What we have to remember is that the future of the economy lies with high technology, and it is true that high technology in the United States is now concentrated in 10 industries which accounted for, and this is a very key figure, a $31 billion trade surplus in 1981, compared to a $50 billion deficit in trade on non-high-technology manufactures.

Of course, we must remember that all industries contain pockets of high technology, and it should be a goal of national policy to enlarge these pockets. This is a goal incidentally, consistent with the automotive industry's stated intent to be second to none in all significant product lines.

In the U.S. system, de facto protection does not really stimulate competitiveness. It may work in some cultures, but not, as far as we can see, in the relationship between government and the productive sector, which applies in the United States.

A third point is that the bill does draw attention to Japanese trade and industrial policies that require some examination.

Of course, we must not get paranoid when we are referring to trade restrictions that may be associated with a particular Japanese Government program. Japan is not alone, we are referring here to the efforts of many countries to build up and stimulate particular industries judged to be of high national priority, usually in the high technology area.

Back to Japan, a specific example is the 1978 enactment of Public Law 84, to promote the health of industries producing electronic devices, computers, and computer software. The related trade and other restrictions are clearly out of line with the reciprocal treatment provided by the United States.

Of course, this gets to the point of a lot of the frustration we are really addressing in the context of this legislation.

The big question is, what do we do about it?

Certainly the bill has had a 2 by 4 effect, and it has got a lot of attention directed to what happens next.

On this point, there are a couple of suggestions we would like to share with you, Mr. Chairman.

Just 2 weeks ago, Mr. James F. Bere, chairman of Borg Warner Corp. and wearing his hat as chairman of the Advisory Council on Japan-United States Economic Relations, before the Senate Foreign Relations Committee, offered some recommendations how we can follow through on specific ways to address some of these trade policy differences which are now of so much concern.

[A copy of Mr. Bere's statement was left with the subcommittee.]

Mr. STOKELD. I will at this point defer to my colleague, Mr. Rooney, from Bangkok, who is wearing a couple of hats today—his chamber hat as a member of our subcommittee on international trade, and also as chairman of a very unique organization, the Asia-Pacific Association of American Chambers of Commerce. This organization is composed of many thousands of American companies and their representatives in the front line of trying to make a living in environments where competition is very, very intense.

[The prepared statement follows:]

STATEMENT OF FREDERICK W. STOKELD

I am Frederick Stokeld, Director, International Economic Policy, of the United States Chamber of Commerce.

The United States Chamber of Commerce is opposed to the Fair Trade in Automotive Products Act because of its negative implications for U.S. economic and trade policies. This is not due to what has been termed a "knee jerk free trade" reflex. It is a position arrived at through a careful consideration of the interests of the Chamber membership as a whole.

Declining production and employment are not merely academic considerations to our members who are vitally concerned with policies to restore these factors of economic growth. If the legislation before the subcommittee held out any reasonable prospect for boosting long-term growth in a key industry, our objections would be limited to its trade policy implications. As it is, however, the legislation is offered as a panacea to economic and trade problems. We believe it will cause more damage than benefits.

A great deal of analysis on the pros and cons of the bill has been presented to the subcommittee during these hearings. Rather than run the risk of repeating in detail what may have been presented already, I will just highlight the major arguments that form the basis of the Chamber's concern with the proposal.

CONSUMER DEMAND

The bill does not address the chief cause of the auto industry's problem—weak consumer demand—the solution to which rests in across-the-board economic recovery. In 1981, total U.S. sales of imported and domestic cars fell to 8.5 million from 11.3 million in 1978. True, the imported segment increased from 17.6 percent in 1978 to 27.3 percent in 1981. But the ability of imports to maintain and expand their market share in this period reflects the shift in consumer preference toward lower priced, fuel-efficient models, a group presently dominated by imports. We do not believe that Japanese exporters in particular possess a built-in advantage over U.S. producers that assures them a forever increasing share of our market. The shift to economy models has been accentuated by the general economic downturn, and heightened consumer concern with value. Again, this factor tends to favor the imports which have specialized in lower-priced models. Over one-half of the total annual United States sales of the three leading Japanese car makers are in their lowest priced series. Even so, figures for 1982 reveal that sales of imported cars also to have continued the decline that first became evident in 1981, underscoring the fact that the relative collapse in consumer demand is the core problem of the entire industry.

Unfortunately, there are no shortcuts to economic recovery. Domestic content requirements will do nothing to bring down interest rates. As interest rates decline, however, and business investment and employment picks up, we will have to consider the effects of pent up demand for automobiles. Since the 11.3 million sales mark of 1978, there has been a cumulative shortfall of almost 9 million units.

This may be cold comfort to our employed at this time, but while addressing domestic content legislation, Congress must realize that automobile sales are likely to rise as interest rates decline significantly.

The avowed purpose of the legislation is to encourage major exporters to the United States to produce in this country. Some are already doing so. Surely it is reasonable to suppose that more would do so if they were confident that such commitments were truly viable.

As noted, there is a huge backlog of demand in the U.S. auto market. Also, the U.S. auto industry is improving its competitiveness through a massive capital investment program. These factors continue to suggest an imminent resurgence by the U.S. auto industry which makes attempts to force the leading Japanese auto producers into a massive shift from exporting into overseas production premature at least.

DOMESTIC INDUSTRY'S REVITALIZATION PROGRAM

The underlying point here is that the legislation does not acknowledge the domestic industry's efforts to increase its competitiveness. It assumes that the U.S. can never compete effectively with imports and needs permanent trade protection. This is a dangerous assumption and a groundless one, when the realities of our long-term trade and economic policy strategy is considered.

The future of the U.S. economy lies with high technology. We must keep to the forefront of the new technologies that are already changing the shape of the world economy and our perceptions of it.

The United States has done well in the new wave of technologies. Nine of the ten fastest growing U.S. industries in the 1980's are high technology industries (communications equipment, electronic components, aerospace, computers and office equipment, drugs and medicines, industrial chemicals, professional and scientific instruments, engines and turbines, and plastic materials and synthetic resins).

Their importance to the economy may be deduced from their disproportionate contributions to research and development, their high rates of productivity and their favorable balance of trade. These positive factors produce benefits throughout the entire economy, creating new jobs as other industries adopt the new technologies.

More specifically, although new technology industries represented only 13 percent of the value of product shipments in 1980 and only 5 percent of total employment, their research expenditures accounted for more than 60 percent of total U.S. private industrial research and development; they also employed more than 25 percent of total scientific and technical manpower.

In terms of real output, their rate of growth was more than twice the rate of total industrial real output.

Their average rate of price increases in the 1970-80 decade was only one third that of the U.S. average inflation rate.

And in 1981, high technology products had a favorable trade balance of $31 billion compared to a $50 billion deficit for all other manufactured goods.

In productivity, the growth rate during the 1970's climbed six times faster than the national rate.

In terms of employment, for every job created in the high technology sector, eight jobs are created in the sectors supplying it, according to the Department of Commerce, based on data from the Bureau of Labor Statistics.

Within those U.S. industries not classified as "high technology," there are nevertheless pockets of technological superiority. It should be a conscious object of national policy to enlarge these pockets.

For instance, the U.S. apparel industry, ten or fifteen years ago, was regarded as moribund and unable to cope with an ever-growing tide of imports. However, the industry tackled its basic problems with innovation and increased productivity. Today, the industry, while still facing massive import competition, is in vigorous condition. Employment has stabilized with exports increasing from one-half a billion dollars in 1978 to over $1 billion in 1981. Of the New York Stock Exchange's top performing companies in 1981, 5 were from the apparel industry.

The domestic content approach to industrial production evades the critical issue of encouraging the development of high technology throughout industry. Within the American environment, with little of the close coordination between business and government policy that is found in some countries, de facto protection is not guarantee of industrial strength and vigor.

FOREIGN TRADE BARRIERS

The legislation does touch on a very serious problem, however, that requires urgent attention—the proliferation of trade barriers in foreign markets against the exports of U.S. high technology industries. As foreign countries endeavor to build up their own technologies, there is a temptation to discourage import competition for the favored industries. Japan's policies toward its semiconductor industry is a case in point. U.S. semiconductor products have only partial access to the rich Japanese market while Japanese products enjoy huge sales in the United States. Inasmuch as export markets, with the economies of scale they entail, are vital for the optimum development of sophisticated technologies, such barriers must be eliminated.

Recent years have shown lessening competitiveness by U.S. high technology industries. This is due to a variety of causes in addition to trade restrictions, including the nature of the government-business relationship in foreign countries; the relative cost of capital; exchange rates, with particular reference to the undervalued yen; labor costs; relative cost and availability of export finance; relative productivity growth; and relative prices and marketing efforts.

It is toward these areas that national policy should be directed as part of a comprehensive economic recovery effort. Trade barriers lend themselves to a speedier resolution than most of the other factors and provide a more realistic and positive target in U.S.-Japanese relations than domestic content.

MARKET ACCESS LEGISLATION

The reciprocity legislation pending in Congress would go far to redress unfair bilateral trade practices. Congress should also support the Administration in its ongoing effort to reduce Japanese trade barriers of special relevance to American exporters.

Other concerns with domestic content legislation can be summarized briefly.

IMPLICATIONS FOR GATT

The bill could trigger a trade war. Because it violates GATT provisions prohibiting domestic content requirements, foreign nations could legally apply for compensation in the form of U.S. tariff concessions. In addition, they would have a precedent for reinforcing their existing tariffs against U.S. exports, particularly in the vulnerable high technology area.

PRICE EFFECTS

The domestic content requirements in Mexico and Australia have resulted in auto prices far above world market levels. These and other examples only serve to reinforce the conclusions of the Congressional Budget Office and others that U.S. auto prices would increase by at least 10 percent if the legislation were enacted.

EMPLOYMENT EFFECTS

Finally, any new jobs created by domestic content requirements would have to be offset against job losses in the U.S. auto import trade and in U.S. industries injured by retaliations.

SUMMARY AND CONCLUSIONS

Domestic content legislation does not address the chief cause of declining sales in the U.S. automotive industry, weak consumer demand. The solution lies in across-the-board economic recovery.

Neither does domestic content respond to the overriding imperative in long-term U.S. industrial strategy which is to stimulate the high technology sectors of the economy.

The bill ignores the U.S. industry's efforts to revitalize its competitiveness, implying that it needs permanent trade protection.

The bill would increase U.S. auto prices and any jobs created would have to be offset against job losses in the U.S. auto import trade and in export industries injured by retaliation.

GATT prohibits domestic content requirements and permits foreign countries to seek extensive compensation in the form of tariff concessions. Particularly vulnerable would be U.S. agricultural products and sectors of high technology manufacturers.

Enactment of market access legislation would go far to address certain bilateral trade practices that are partly addressed in the bill. The U.S. must increase its efforts to induce foreign countries, especially Japan, to reduce trade barriers against American exports.

The best prospect for American industry lies in the recovery of the entire economy. Government policies to reduce interest rates, check inflation, stimulate capital investment and lower foreign trade barriers are the tools to meet foreign competition.

Chairman GIBBONS. Mr. Rooney, go right ahead.

Mr. ROONEY. Thank you, Mr. Chairman.

We welcomed your trip to Asia last year, and we wish you would come back again.

Let me address two points. Many of us in Asia live in countries that enacted local content legislation. The reason for putting the legislation in place was primarily to try to develop a spare parts industry in countries where they were bringing in CKD, or completely knocked down, units to assemble in those countries.

What resulted was the establishment of a number of automobile assembly plants which initially competed with imported completely built-up units.

At the time when the United States is considering a local content legislation, it may be well to look at the experience of some of these countries. In the country I live in, the country and the government is now reviewing whether or not they should do away with local content legislation.

The reason for this is that the result of a high local content requirement is a more expensive vehicle, much more expensive than the actual import of a completely built-up unit, and, second a lower quality automobile.

They found in most particulars that the legislation simply was not beneficial to the country as a whole and are now reconsidering whether or not they should keep any portion of that legislation in place.

Second, let me address a topic which we as Americans doing business in the Asia-Pacific area feel is our item of first priority, and that is this entire question of market access.

We see the necessity to reduce the impediments and barriers to trade. We also wish to see a free market enterprise continue.

We feel, in dealing with our competitor nations, that a steady continued pressure should be brought to bear at all levels of our negotiating areas, at all levels of our government, to work to reduce these impediments or barriers.

At a time when our efforts are being directed toward reducing our trade barriers, increasing our market access, we feel that it would be a mistake to set the example, by taking protectionist or reciprocity-type actions which, in turn, could be used against us in the long run.

We feel that many of the countries in which we do business have a greater national awareness of the importance of exports; that it is more critical to them and the success of their economy, and that this awareness has extended throughout the population as a whole.

We also, in many cases, see an integrated international economic policy that is designed to further these efforts.

When my company was first established abroad, we focused a tremendous amount of our attention to what we felt were barriers in our host country.

For the past 6 or 7 years, we have directed more of our efforts toward our own country, the United States, in urging that we become more competitive.

Areas we have looked at are the Export Trading Companies Act, adequate and aggressive export financing, Foreign Corrupt Practices Act, antitrust laws, and the taxation of U.S. citizens overseas, and others. We found your committee has been very receptive on these issues.

There should be a great awareness on the part of Americans doing business overseas.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Mr. Rooney. We remember very well our visit with you and your colleagues in the Far East, and, speaking for myself, it was a very enlightening experience to see the economies there.

One of the most impressive things that I learned in the whole trip was about the issue of domestic content.

Some member of our party raised with a head of government in Singapore, Mr. Lee, a question of whether he thought the ASEAN countries should engage in the manufacture of an automobile there, and he said no, we don't want an expensive high-cost automobile.

We can make one cheaper, ourselves.

For the head of an emerging country like that, that was a very brave statement, but it was based upon his experience, what he had seen in other ASEAN countries, that led him to that conclusion.

Certainly, if it is true for them, it is certainly true for us.

I think Mr. Fox and all of you have given very thoughtful statements, and, Mr. Fox, particularly your statement has a lot of good positive suggestions in there.

I had forgotten it had been almost 2 years now since the UAW and the automobile industry have brought that case for injury in the ITC, and perhaps we should ask for another investigation.

I think the injury is more self-inflicted than inflicted from the outside.

I do not wish to blame all of it on the management and labor involved in the industry.

Obviously, a lot of it can be blamed on the fact that the interest rates have been excessively high and the Government has made some mistakes in policies; that is, about the pricing of fuel, that has accounted for the problem.

We expect a better performance from an industry that has such a large segment of our economy.

Let me ask this panel, do you feel that the Japanese have been unfairly influencing the value of their yen, the price of their yen, their currency?

Mr. Fox. Perhaps I might respond to that first.

I have written extensively on that subject, and I will make available for the record materials submitted in connection with the financial conference at the conference board.

In the material also was a letter from our president, A. V. Trobridge, to the Secretary of the Treasury on this subject which deals with it extensively.

That was followed up by a meeting with many key leaders in our industry, Mr. Trobridge and ourselves with the Under Secretary of the Treasury, Mr. Beryl Sprinkel, on the subject of the yen.

Chairman GIBBONS. When can you get that material for us?

Mr. FOX. Part of it is part of the testimony. We will give you the balance of it tomorrow. I can summarize my view, though, in response to your question, quite quickly.

I think it is a mistake for us to look for somebody in a black cape and a black hat at the Bank of Japan working to push the yen down.

There are two important explanations. One, as part of Japanese industrial policy for 30 years, it has been to have an undervalued currency. They understand an undervalued currency gives them an export advantage and makes imports more expensive. The Japanese have never forgotten that.

Second, in the era of floating exchange rates, the value of the yen, of course, interacts with the value of the dollar.

There are sort of two consecutive circles: First, the international item of which the dollar is the key. That tends to push up the value of the dollar. The value of the dollar is dependent on a number of factors, not just our performance in the Trade Act: U.S. interest rates. The United States is a safe haven for currency. If you have a lot of money and are worried about losing it, you put it in the United States rather than in a risky bank elsewhere.

In any case, the value of the dollar is not determined by trade competitiveness as much at this time as it is determined by the movement of capital, which has been in our direction because we have high interest rates and other conditions that make the United States an attractive place to either invest money or deposit money.

The other circle is the Japanese circle which is designed to isolate Japan from the ramifications of the international monetary system and to provide them the opportunities to carry forward an independent monetary policy.

The objectives of the independent monetary policy, in part, have been quite understandable: to keep interest rates low in Japan, to reduce the level of inflation in Japan. It is a great thing if you do not have to worry about the total picture Paul Volcker has to worry about, the Governor of the Bank of Japan has isolated his country from the international market in both capital and current accounts to a considerable extent.

The ability of the Japanese to maintain a capital market quite independent of the rest of the world is very important in this respect: The question was asked how do the Japanese finance their budget deficit which proportionate to GNP is larger than our own?

One answer is that the Japanese borrowers, the Japanese Government, have the advantage in that the Japanese lenders, meaning the banks, pension funds, and savers of Japan willingly—the savers willingly accept 5 percent rather than go to New York and get 15 percent for their money.

Why is that? Why do they pursue that anti-economic behavior? It is because that is the Japanese approach to national interest.

I think if one understands that the basic international system tends to push up the value of the dollar, and the Japanese efforts to isolate themselves from many of the consequences of the international monetary system and occasionally they have intervened to keep the yen from appreciating, although at the moment they would like it to appreciate because the yen is so cheap, but the interaction of those two systems produces this peculiar result: that the most competitive economy in the world, at least speaking in the industrial sector, has seen its currency depreciate againt the dollar by 25 percent.

The solution to that is to examine these problems where they belong to be examined, namely, in the IMF. Article 4 of the IMF requires that no country advantage itself with respect to the exchange rate and its results on trade at the expense of others through policies that are of an intervenionist or characteristics that could be described as inappropriate in relation to the IMF rules.

NAM and NAM member companies urged to Secretary Sprinkel to seek an IMF article 4 review of the relationship of the Japanese currency to that of the United States and to other currencies; to do so in a nonconfrontational kind of way, to do so in cooperation with other countries.

The Council of Ministers of the European Community on February 22, last, directed their finance minister to raise with Japan the question of the exchange rate and why the Japanese yen is going down when its competitiveness is going up.

The European Community at the same time initiated an article 23 action under the GATT which, in effect, asked why the trade concessions made to Japan shouldn't be modified inasmuch as reciprocal issues have not been provided by Japan to the European Community. That is being pursued at this time.

Our first approach to the value of the yen is to understand better the interaction of the monetary system, the U.S. role in that system, and the peculiar ability of the Japanese to participate in that system financially in a limited way and in a very selfserving way from their own national interests.

Chairman GIBBONS. You said there is nobody in a cloak and dagger manipulating the yen, but how have they achieved this?

Mr. FOX. My suggestion was a black hat and black cape but no suggestion of a dagger. That man does not exist, but there was a time when there was a fixed exchange rate with a dollar which existed until August 15, 1973. The United States provided the undervalued yen by the Bretton Woods system.

Since that time the yen, along with many other currencies, including the dollar, has basically varied with a system that is loosely described as floating exchange rates.

In 1975-76, when the yen had appreciated, it reached its strongest point in 1978 when it was 1979.

In both of those occasions, the Japanese intervened to strengthen the yen, that is by foreign currency transactions. At the beginning of 1981, the yen was less than 220. The market simply finds the Japanese environment not an appropriate one to make heavy investments, one you can't borrow more than you might like to borrow. You have to stand in line and the Japanese authorities will approve perhaps one or two borrowings in Japan.

Second, the Japanese do not permit their currency to play a role in international transactions.

As Mr. Mitt, the AMF representative, indicated, the Japanese have resisted the yen playing a role as a transaction currency in the international monetary system. Yet, their trade played such a tremendous role.

If the yen played that role in the international system, there would be greater demand for the yen and the price of the yen would rise.

These are complex matters. I am not suggesting in any way that there is a flip answer; but the United States has never suggested that the IMF in the way I have described it review the interaction of the total system, the American role in that system, and the Japanese role there.

I think that would be the first thing that any government interested in the competitive position of the United States would do in the face of these continued observations that the yen is seriously undervalued.

The Treasury does not particularly want to do that. I think the Treasury has in this instance an unfounded faith on the efficacy of the market. I think there are factors that are taking place that are not really market-related factors that are determined by the nature of the system and the Japanese response to that.

Chairman GIBBONS. I still don't know how they do it.

Mr. ROONEY. Mr. Chairman, if I might add a couple of comments, I would support what my colleague says.

I think there is one element we tend to overlook when we think about Japan. That is that Japan, for a long time, has realized the necessity to export and to sell. It went through some rather tenuous periods when they produced low quality goods.

The Japanese no longer produce low quality goods. They lost some sales to competitive or predatory export financing. The Japanese lose very few sales now. The Japanese in all aspects of their life identify with the necessity of exporting.

I do not feel that we at this time do. I do not feel that we have that same sense of necessity, the same sense of urgency towards exporting that we see in the Japanese.

As to the reference to the support of their activities by the purchase of low-priced bonds within the country, the Japanese have been doing that for a considerable period of time. It has been very effective; but this is related to an overall, national identification of priorities. One of those priorities is to export and to sell.

I would also like to mention that I feel as we look at this problem on a broader perspective that the problem is not just the Japanese. We are out there competing with the Japanese, the French, the Germans, the English, and the Spanish.

I was down in Singapore two weeks ago buying some integrated circuits. I felt when we found the ones with the lowest price they would either come out to be of United States manufacture or Japanese. They were Italian.

We are competing with many people in this world marketplace, not just one.

Second, our major battles in the trade area are not limited to the competitive battles between the United States and Japan. It also is where we are meeting Japanese and other national competition in third countries, where we are selling larger major projects, capital goods equipment, and are in direct head-on competition with these countries.

That is one of the areas where their dedication and identification to the national priorities often gives them an edge over our own.

Chairman GIBBONS. To summarize for all three of you, none of you want this bill; is that right?

Mr. ROONEY. That is right.

Mr. FOX. That is right.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. Thank you very much, Mr. Chairman.

The subcommittee is grateful for the appearance of all of you. We appreciate the message that you have brought to us. It isn't stunningly different from that which others have given us; nevertheless, in combination with all the others it paints a pretty high risk of danger sort of picture for this piece of legislation, should it unfortunately escape this committee or this Congress.

I was interested, Mr. Fox, in your testimony. On page 3 you talk about the emphasis on automotive products being deceptive.

Is your belief through your experience that, should this be passed, we would then have the steel bill and the mushroom bill and the rice bill following it shortly?

Mr. FOX. That would be my expectation, not that the Congress would necessarily seek that result, but old cliches have a certain history: The nose of the camel under the tent, the foot in the door, all mean that. It would be very hard, it would seem to me, from a political standpoint, to explain why this industry is entitled—and the workers in it—are entitled to one type of treatment which is available to no one else.

Mr. FRENZEL. You state on page 4 the United States has vital interests in the international trading system. Yet, most Americans don't understand that.

If you would ask an American on the street whether he or she believed in free trade, three-quarters of them would say that it was a good concept.

If you ask the same sample whether it was worthwhile protecting domestic industry to relieve unemployment, probably three-quarters of them would say yes as well, not being able to make the correlation.

What ought we to do to make America more trade conscious so they would understand that when we yield to the nobly intentioned goals of the auto worker we are going to hurt other segments of our industry much more than we would benefit those of the auto sector. How do we get that point across?

Mr. FOX. Mr. Frenzel, I think that is a very serious question. I think we have all failed at it. NAM has failed. The Congress has failed. Every administration has failed to provide an adequate public understanding of the importance of trade.

It goes back to schools and to the media. I think the current issues with respect to automobiles and the unemployment in that industry has attracted the attention of the media.

I think we all have an obligation to try to explain this issue more fully; but in day-to-day life, the short-term tends to preoccupy one over the long term. The benefits of trade can be appreciated over the longer term more readily than the pain of unemployment.

I think this is a very difficult but most important time to make this educational effort.

Mr. **Frenzel**. We are grateful to both of your organizations for the promotion of the importance of trade. We hope that we can inspire more to take the same kind of attitude that you have taken.

You say on page 4, in 1981, Japan's surplus of manufactured goods was 115.6 billion. Wasn't that the year where Japan about broke even in total balance?

Mr. **Fox**. In 1981, they had a surplus, a global surplus—by the way, that trade figure is in manufactured goods—but in 1981, they had a global surplus in their Trade Act, not just a trade surplus.

The purpose of the statement basically is to indicate not that Japan does not have to pay out a lot of money to import oil, et cetera; the purpose of the statement is that we are supposed to be the leader on the industrial side and all we can generate is $5 or $6 billion of a trade surplus in manufacturers; Japan was over $100 billion; Germany was at $62 billion.

We are not doing very well. Obviously, if we are not doing well, part of that is our own responsibility. It is not just that the Japanese have done so extremely well. Part of our difficulties relate to wrong priorities in Government policy, wrong priorities in management's policies, and to deficiencies in our own approach to competitiveness.

That was the point of the statement.

Mr. **Frenzel**. I think it is an excellent point. That is what I wanted you to say.

It seems to me that most of our injuries are self-inflicted. We have provided ourselves in the DISC an inadequate incentive which is, of course, under contest, and may ultimately be lost by our unwillingness to promote the export trading company bill fast enough.

We have lost opportunities for smaller companies; with the Foreign Corrupt Practices Act we have handcuffed ourselves; licensing procedures are an international joke; pipeline policy is the same; our abuse of the Export-Import Bank is helping us not to make jobs in America by increasing our exports.

You can run down the whole list. Most of those things we have done for ourselves. It is not some great foreign cabal conspiring to make our lives tougher in international trade. It is us. Somehow we don't seem to be able to put it together.

Apparently we are not very good salesmen up here. I hope you will be better ones down there.

I want to thank our friend, Mr. Rooney, who was a most gracious host to us and simply ask him what will be the practical effect in—for American business in Bangkok with the passage of this kind of legislation?

Mr. **Rooney**. In terms of the immediate effect, it would be very difficult to say exactly what would happen.

However, if the United States were to pass a piece of legislation such as this, I feel it would seriously hinder our efforts to work with the Thai Government to reduce restrictions or barriers that exist in Thailand.

We have several issues that we are working with the Government. The Government has been responsive. They have been responsive to our arguments and receptive to our ideas.

We feel if we were to go in with a strong piece of legislation such as this just being passed in the United States, that they may sit back and say why should we take the lead when your own country is going in the opposite direction?

I see that as a very real danger in trying to open your market access in those countries where we do not have it.

I would also like to say in a way you have just expressed our litany of problems that we face and many of them are self-inflicted. It is not easy for us to do business overseas. It is not as easy for us to do business overseas as it is for our competitor nations. Just the difficulty in selling a U.S. product overseas, I feel, has led to a large extent to a dominance of attention to domestic sales.

If you are in California, it is certainly easier to sell something in Nevada, or Idaho, or Wisconsin, than in Thailand, France, or Europe.

Mr. **Frenzel**. Foreign trade in Minneapolis is to send a salesman to Winnipeg every month.

Mr. **Rooney**. So we would encourage the efforts you have already taken in assisting in the legislation that we have mentioned to try to simplify our process, to try to do away with the barriers that we have, and to indicate to the rest of the world that this really is our policy.

On the other hand, we very strongly feel we should maintain this constant pressure to reduce barriers to trade. We would like to see this go hand in hand along the way.

Mr. **Frenzel**. I must agree with you at least since I have been in Congress there has been really one constant clarion voice demanding a reduction in barriers and expansion of the free trading system. That has been our country.

We occasionally get supported by the Federal Republic, by Singapore, by Hong Kong, or by some other major world power, but most of this we have done on our own.

As a matter of fact, despite the allegations that we are always outfoxed at the international bargaining table, we haven't done too badly. We have managed to increase our trading share pretty well. As a matter of fact, we are about now in double digits, aren't we, in terms of our—in terms of the proportion of trade to our total economy?

Mr. **Rooney**. Yes.

Mr. **Frenzel**. It seems to me when I came to Congress we were around 4 percent.

Mr. Fox. We are now exporting, Mr. Frenzel, 20 percent of our goods output.

Mr. **Frenzel**. I mean in terms of the total economy. What is the combination of exports and imports?

Mr. Fox. In terms of GNP, it is over 10 percent now. It depends on your definition of services.

Mr. **Frenzel**. That is, of course, going to rise. It has to. It has no other place to go.

Well, again, we are very grateful to you for pointing out some of the—not only the difficulties of this job, of this bill, but also the—some opportunities that are available for us abroad. That isn't going to be satisfactory to the UAW, because they would like opportunities today, or tomorrow, or at least by next year; but at least from the standpoint of trade and how it relates to your companies, you have not only pointed out the danger, you have given us alternatives. We are very grateful for that.

Chairman **Gibbons**. Well, if you export 20 percent of what you manufacture, and a third of what you grow, you are doing pretty well in the trade thing.

Mr. Bailey.

Mr. **Bailey**. Thank you, Mr. Chairman.

Mr. Stokeld. I want to thank you for a statement that I think characterizes this legislation better than anyone has at any time during the entire and total public debate on it.

You simply referred to it as a 2 by 4 in a certain context.

I don't quite know whether you were thinking of its application to the posterior or anterior ends of the respective nations we sometimes discuss here, but I think it was an apropos reference at least for me.

I appreciate your making that statement.

Mr. Fox, if I had a wish I think that right now I could get something in front of every Congressman in the United States, it would probably be to petition on the Houdaille matter.

I have read the petition, the briefs, the whole thing, front to back. I noticed your summary here.

I thank you very much for including it. I am hopeful the chairman and Mr. Frenzel will read that portion of the statement. I am sure they will. I hope the other members of the committee will read it.

I also hope you will include that thing for the record. I don't think it is very voluminous.

Mr. Fox. Mr. Bailey, attached to our statement here, we have our petition to the USTR in support of the Houdaille case which is a fairly convenient summary.

Mr. **Bailey**. It is good, but you see, I got an actual copy of the briefs.

I would wish that somehow you could get that at least for the chairman if you can, so that he and the staff could look at it.

Mr. Fox. We will undertake to do that.

Mr. **Bailey**. One of the things you don't deal with in your summary are some of the business practices that are reflected in detail in the petition.

I think you know what I am talking about. There is an intent issue that should be looked at, because the design that was made on going after that market involved a very explicit and very careful and very deliberate analysis of marketing in the United States of America, selling those products, and splitting up certain portions of that market among certain companies; am I right?

Mr. Fox. Yes. If you permit me, I will make a little more general observation. I have studied the competitive picture with Japan for a long time.

When I was in the Government, I think I must have taken a dozen trips to Japan on one trade issue or another.

I have concluded, after some thought, that the essence of the Japanese competitive challenge is not really the Japanese social attitudes and the worker who comes to work and does deep knee bends and salutes the machine and sings the company song.

The essence of the Japanese competitive system is cheap money; cheap money means money is made available through the banking system, through the tax system, and through other means to those industries which are to be made more competitive. That includes export credit.

Mr. BAILEY. Let's add in something, Mr. Fox. If you want my opinion, your testimony has been about the best, I think. Clearly from the reading I have done, I would yield to your expertise.

As nearly as I can ascertain, you are probably the most knowledgeable on these general matters. I am really impressed with it.

Could you throw one little thing in there, though? You are talking about this cheap money. You threw a phrase in there that caught my ear. You said those industries which apparently are chosen. That raises the specter of this concept, this term you use in your statement and in your appendix here of industrial policy.

Would you comment?

Mr. Fox. Yes; Japanese industrial policy, in my opinion, has had three essential elements since the end of World War II. One is a goal to develop the industrial side of the economy.

Mr. BAILEY. You mean a deliberate goal?

Mr. Fox. A goal.

Mr. BAILEY. The government participates in this decisionmaking?

Mr. Fox. That is a government goal. It is shared by labor, by industry, it is a national consensus. To achieve that goal, they have a concept of the elements that make an industry competitive.

In my view, the essential features of that concept are cheap money. Put your money where your policy is.

Second, they have an industrial policy which facilitates exports through persistently undervalued currency and makes imports more expensive in the same manner.

Mr. BAILEY. Mr. Fox, Mr. Stokeld, and Mr. Rooney, I would assume that throughout this whole thing, we do not feel that is a good policy for the United States of America to pursue; and that, quite frankly, we do not think that is the best free enterprise model we would want to emulate.

Mr. Fox. My statement as to the third element of Japanese policy, and then I will respond to your question.

The third element in Japanese policy is selective use of cartels. A cartel is a wonderful thing. When those guys get together to plan their exports, they are also planning their imports. There is not much room for anybody outside the cartel.

The machine tool industry shows that and many other industries show that, including semi-conductors and computers.

Responding to your question, I don't think the Japanese example is a particular good one for the United States. I think we have to pursue this in our own way; but one of the elements of pursuit of that objective is to recognize that we are forgoing jobs, we are forgoing industrial growth by not paying attention at either the macro level of the contribution that foreign trade can make to our growth in GNP and we are failing to take the steps necessary to eliminate the impediments to our growth. That includes impediments such as, in my opinion, unnecessary restrictions on joint R&D research.

We are failing to make it possible—at least we are failing to this day, I hope tomorrow it will be different, we will pass the ETC legislation—we are failing to make the necessary commitment diplomatically to make other countries aware that we require that their markets be open more fully or the consequences will be as unpleasant to them as to us.

We have talked about that. We started out with an inadequate reciprocity bill in the Congress. I think the present version of that bill is much better and is a step in the right direction; but we have not pursued with adequate vigor nor persistence the opening up of foreign markets to American goods.

Mr. BAILEY. Mr. Fox, if you will take everything that you have said and then go to make one little, not really a quantum leap incidentally, make just a little bit of a jump over to Mr. Stokeld's 2 by 4 and then you will understand why this bill is getting a lot of attention.

I think that is fantastic. It is great when you hear somebody that reinforces your ideas.

I really wish your organization politically, and that is probably not your policy or your fault, would do as much, if they at least have your view of an industrial policy or maybe tax issues or what, I don't know.

I don't know if you and I agree on some solutions, but we certainly agree on the problems, particularly in the case of Japan.

I think what Japan is doing is very dangerous. Japan has got to learn that she needs very, very badly with our fantastic potential, to do things in a little fairer way or a little more open way or she is going to do violence to world free trade among free nations. I really believe that.

I have talked to representatives of other nations, and they seem to share many of the conclusions that you have, and they feel some violation there and they have reacted in some ways. They have tried to protect this or protect that and Japan is the most glaring example to us, because we feel she is hurting us.

She is not alone in doing these things, just a little more set in her ways.

Politically, we have had some solutions offered in this country. I was very saddened to see some of the approaches your organization took on the recent tax bill, and the first one, particularly on some of the business issues.

I know the chairman here headed up a task force that made some fantastic recommendations but for political reasons, they were not followed.

If you wish to comment, you are welcome to, but I don't think it serves the interests of the country for any organization to be too partisan and sometimes you have, if I may accept criticism from a Democrat who has some very conservative viewpoints.

That is my viewpoint. You talk about shooting yourself in the foot and everyone has talked about domestic policy.

What would you recommend we do here at home? I don't think you can talk about the American argument, free trade, and not be a hypocrite when you are not standing behind some policies at home to deal with the situation. You are not going to change the Japanese overnight.

I would like if you could send me the material personally on the currency stuff. I would love to study that. What would you recommend we do with our tax code here, antitrust in particular, which is an interesting area to look at, an industrial policy.

That smacks of planning, just a little bit, you know. That is a concept we don't like. What would you recommend?

Mr. Fox. I do believe that a very large part of this problem in our domestic economy, and mistakes which the government has made in some of its policies, mistakes which industry has made in some areas, and in certain areas, labor costs have gotten way ahead of productivity in an industry and created additional problems.

The solutions in the domestic economy are obviously complex.

Mr. Bailey. I mean long term, Mr. Fox. Go out there 15, 20, 30 years.

Mr. Fox. They do relate to increased savings and increased investment. They relate to improved quality of product and less attention being paid by industry to dressing up the bottom line, and merger attempts.

The quality of the product has to be the emphasis of the 1980's and the 1990's among other things.

A trained work force is very essential. Efforts to move ahead into the new age that is before us with a certain portion of our population deprived of basic skills to read and write and compute is a tragic mistake.

Additionally, training through apprenticeship where there is a role for industry and labor unions in such training.

Mr. Bailey. We have that. We have a role for industry. The trouble is, we don't have the resources. We also push away the government role.

Are you hedging or are you talking about a different nature of the relationship between government and the private sector?

Mr. Fox. No, I do not see the United States emulating the Japanese style of industry-government cooperation. There is a lot of closer understanding between the German industry and government and labor plays its role also.

I think we have to respond to the new conditions with new approaches.

I am really not in a position to lay out a total plan to that end at this time but it is important to bear in mind that our overall competitiveness turns primarily on what we do in the domestic economy.

In specific areas where we have great difficulty competing as we do with Japan and in certain product areas, because they have successfully used industrial policy, then we have to figure out an appropriate response to that.

I rather think the response is different for each industry.

I have rather good confidence that the American automobile industry will come back. I am not sure it can come back during a recession with 14 percent interest rates and no demand. The Japanese don't suffer from any of those difficulties.

Mr. **Bailey.** I agree with you but the gentleman sitting on your right, his organization opposed the recent tax bill and I happened to vote against it.

I think you folks were for it. I may be mistaken.

It took the best out of what was the original ERTA and went after it and I think for political reasons. I know you can't defend that one, and I won't put you on the spot and ask you to. I just think that really what is going on in the United States, and the whole thing has been a blessing in disguise, is, as a country, and I have seen the labor unions are beginning to do it, we are starting to reevaluate philosophically, because the issues go right to the core of government, industry, and what free enterprise means in a modern age.

There is a kicker behind all of this. I served on the Armed Services Committee, and the more I studied, the more I realized, when you talk about military strength, peace, a set of values that you love and cherish and are willing to fight and die for, you are talking about the needs to maintain the skills, investment, long-term policies that preserve this Union. I am really concerned about what this model can do for the world in its being exploited or misused and yet we are going to have to write some new policies that deal with some of these problems, and for example, talk about the government role in financing.

One of the most unaddressed issues in the United States of America, is the role of a government in financing exports. What subsidation means under the GATT.

I am intrigued by the different definitions of what subsidies means in different countries, investment tax credits, what role they play.

I just think your testimony, all of you, has been excellent.

I hope everyone will read the Houdaille matter. I am delighted that you included that here. It would do more for this subcommittee if every member would just read that case.

ABC did a tape on it. Maybe we can get back after the elections, we can show it, it is a fascinating educational brief. I thank all of you very much.

Chairman **Gibbons.** I thank you, too, and this will conclude our hearing, but since we are putting Mr. Gleason's statement in the record, I have had a chance to read it, and he concludes on page 4, "I therefore, urge you to table this bill"—this is Mr. Gleason, the head of the International Longshoremen's Association—not because it is ill-meant but because it is ill-conceived. "It will create far more dust than it can settle."

Mr. **Bailey.** Can I read a section of his comments, too, Mr. Chairman? He does agree.

On page 2, the Longshoremen's, I can understand their union and the views they have to take, and I respect that. In terms of unloading cars that come in, they are in a different situation.

On page 2, in the case of the Japanese, the measure before you will aggravate and harden the situation, rather than seek changes through persuasion and appeals to self-interest. We all know that trade with Japan has become too much of a one-way proposition. It hasn't only been limited to automobiles; it encompasses full or partial bans on a whole range of American products that are not permitted to meet the existing and potential demands of the Japanese consumer market, so that Japan's balance of trade—but not ours—artificially remains favorable.

[The prepared statement follows:]

STATEMENT OF THOMAS W. GLEASON, PRESIDENT, INTERNATIONAL LONGSHOREMEN'S ASSOCIATION, AFL-CIO

Gentlemen, my name is Thomas W. Gleason. I am the International President of the International Longshoremen's Association, AFL-CIO. The ILA represents over 100,000 longshoremen and employees in other occupations affecting—and affected by—domestic and international trade.

The ILA can appreciate the motives and responses of H.R. 5133, The Fair Practices in Automotive Products Act. It is an attempt to seek relief for an important home industry that is facing rapidly increasing competition, in particular from the Japanese auto industry.

I submit that the solution that that industry seeks, through passage of the bill before you, is not the appropriate or most effective answer to a serious problem. It attempts to handle the situation on an ad hoc basis, without ample consideration of the impact on our country and its trade relations as a whole and the implications for other American industries as well.

The longshore industry is certainly a case in point. Over the past two decades, automation and the adverse actions of federal agencies have resulted in the elimination of many millions of longshoremen-hours. Thousands of jobs in backup industries such as trucking, warehousing, insurance, processing and so on which depend for their very existence on shorefront activities, at a ratio of about five backup positions for every longshoreman, have also disappeared.

If the intended effects of H.R. 5133 actually come to pass, then we foresee extensive loss of international cargo which our members handle, to be followed by raised tariffs, cuts in foreign shipments of American products, and other retaliatory measures. These will further erode whatever work remains in the already hardpressed longshore and shipping industries.

This piece of legislation, though it seems narrowly-addressed and confined to a single industry, could be—and would be—used as a precedent to open the door to similar bills yet to be sponsored on behalf of industries that also face trouble because of over-reaching and inequitable trade practices. It will not be long before all our international trade is conducted by congressional statutes written in stone, rather than through flexible negotiations and the selective uses of economic power. This traditionally and for pragmatic reasons has been the province of the Executive branch of government, which conducts our day-to-day foreign relations.

In the case of the Japanese, the measure before you will aggravate and harden the situation, rather than seek changes through persuasion and appeals to self-interest. We all know that trade with Japan has become too much of a one-way proposition. It hasn't only been limited to automobiles; it encompasses full or partial bans on a whole range of American products that are not permitted to meet the existing and potential demands of the Japanese consumer market, so that Japan's balance of trade—but not ours—artificially remains favorable.

Japan, like other governments who perform the same trick, must be made to understand we will not deal piece-meal with them like they do with us. Yet legislation that deals with only part of the problem cannot offer a lasting solution. American industry and the American economy is an integrated one. Whether it be autos, or farm products, or steel, or computers or services, there are ripple effects elsewhere within our system. The example that I gave you of the potential effects of this bill on our own industry can be multiplied a hundred or a thousand fold when one considers the actions of—and counteractions to—Japanese trade policies. The time for action is upon us!

What we need is a broad—not a limited—approach to the underlying problem. It really has to do with Japanese and other foreign attitudes that overprotect and subsidize their constituents, while seeing American industry and consumers as ripe for the picking. That is the type of "foreign aid" you don't—possible can't—legislate, unless we're going to go back to those days when we were an "island republic". The President, through his Trade Representative, is the appropriate party to drive the message home to our trading partners: Protection and invasion are not the answer;

rather, responsible, even-handed trade policies are the only way to keep all of our economies in balance if the Free World is to stick together and succeed.

I therefore urge you table this bill, not because it is ill-meant but because it is ill-conceived. It is a fragmentary approach that will complicate our own responses, hamstring our negotiators and create far more dust than it can settle.

This does not mean that the basic problem is to be swept under the rug. To the very contrary! It is precisely because the proponents and supporters of this bill have felt the need to go to such great lengths to remedy what they and our own members see as a festering and growing adversity, that the Administration must devote more strenuous efforts and determination to rectify it through the means at their disposal.

We in the ILA intend to do whatever may be required of us to back up the Administration's posture in bringing these matters to a head. It must be done in the context of an overall reconciliation of conflicting national and international policies and interests.

In a sense, all American labor and industry today is in the same vulnerable boat. We have to stay afloat together, not separately and certainly not by going our own ways. We must all pull together in supporting our trade bargainers. That's how the job will get done the right way, not, as this bill will tend to do, the wrong way.

Thank you for inviting me to present our position on this important matter.

Chairman GIBBONS. We will meet tomorrow at 9:30 a.m., in room B-318 of the Rayburn Building.

Our witnesses will be Mr. Roger Smith, chairman of the board of General Motors, a representative for the National Association of Stevedores, and others.

Thank you very much.

[Whereupon, at 4:45 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Tuesday, September 28, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

TUESDAY, SEPTEMBER 28, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met, at 9:30 a.m., pursuant to notice, in room B-318, Rayburn House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen. We seem to have suffered from lost members.

Our first witness this morning in our continuation of the hearing on H.R. 5133 is from the General Motors Corp., Mr. Roger B. Smith, chairman of the board.

Mr. Smith, if you would come forward and take the chair up here, we would be glad to proceed.

Mr. Smith, welcome to Washington.

This legislation has the potential of being one of the most serious pieces of legislation that the Congress faces in the eighties. As I have said before, I do not expect it to become law this year because it looks like time will run out on us, but it is a serious matter for the future.

I hope that U.S. business and the U.S. Government working together can solve our problems. I do not think this is the proper solution. I am anxious to hear from you, sir.

STATEMENT OF ROGER B. SMITH, CHAIRMAN OF THE BOARD, GENERAL MOTORS CORP.

Mr. Smith. Thank you very much, Mr. Chairman. I am delighted to be here today.

My name is Roger B. Smith. I am the chairman of General Motors Corp. and I am appearing before the House Ways and Means Subcommittee on Trade to discuss our views on legislation requiring domestic content in automobiles sold in this country.

First let me say that there is no doubt that the automobile industry has been experiencing difficulties.

Sales of cars and trucks in the United States for the 1982 model year will total approximately 10 million units. That is the lowest volume since 1964, a period of 18 years.

The economy into which we must market our products has been a major contributing factor to the industry's diminished sales performance. The United States is just beginning to emerge from some

3 years of economic stagnation, a situation made longer and more severe by record high interest rates.

The prime rate stands at 13.5 percent today, but it was 20 percent just before our new models came out last September. Besides contributing to the general economic weakness which has depressed the incomes of our household and business customers, high interest rates pose particular problems for such interest-sensitive industries as autos and housing.

The high cost of government regulations also continues to severely impact the industry. At a time when inflation was already pushing up the prices of cars, equipment required to comply with safety, and emission regulations has added approximately an extra $1,100 to GM sticker prices.

Despite the good progress made thus far by the Reagan administration in reducing the burden of Federal regulation, the automobile industry and the rest of society remain highly regulated. In fact, several hundred new regulations have been proposed or imposed by the Federal Government, including the independent agencies, since the first of this year.

While some of the regulations are, of course, necessary, clearly much more can and should be done by Congress and the regulatory agencies to reduce the extraordinary financial and personnel burdens required to comply with regulations.

Intensified worldwide competition has also been a major challenge. The oil shocks of 1973 and 1979 abruptly shifted the market in favor of foreign manufacturers. With gasoline no longer cheap, the shift to smaller cars occurred practically overnight—faster than the American automakers could respond, given the long lead times which govern our industry.

It takes at least 3 years to get a new vehicle from the design stage into production. Foreign manufacturers were able to respond quickly to this market shift with cars designed and produced for their home markets where fuel costs already had been much higher and driving patterns significantly different from those in the United States.

But as we have been able to build new products designed to provide American consumers with greater choice and to meet our foreign competition on a more equal footing in the marketplace, we have been more than able to hold our own.

The new compact pickup trucks introduced this past year by GM are a prime example. These S-10 and S-15 trucks are No. 1 in their market class, outselling any individual competitor, foreign or domestic.

Similarly, the domestic industry's lineup of new, more fuel-efficient cars has also made notable progress against the competition from the rest of the world, excluding Japan.

Admittedly, the whole U.S. car market is down this year. Looking at the 1982 calendar year through August, we see that imports or import-sponsored makes—excluding those from Japan—have experienced a drop in volume of about 25 percent from the same period as last year, while domestically built cars are down about 14 percent.

So we know, given a fair position, we can meet and beat the competition.

Japan is unique for several reasons, which I would like to discuss later.

Overall, at General Motors, we see the current problems of our industry as a triad. There are problems that management alone must solve. There are problems that management and the unions working together must solve, and there are external problems over which only governments have control.

I would like to describe each of the problems briefly and some of the ways in which we are working to solve them.

First, management's problems. As I indicated, the oil shocks of 1973 and 1979 significantly altered the pattern of consumer demand in the United States. At the same time, lower growth in demand and worldwide industry overcapacity have fostered a more intensely competitive environment.

American-based manufacturers, led by General Motors, are responding to the challenge with massive programs to produce new lines of cars and trucks and to revitalize the manufacturing processes.

Extensive efforts have been undertaken to improve all areas of our business—production facilities, the use of human resources, and the cars and trucks themselves.

Following the 1973 oil embargo, GM responded aggressively to the intense consumer demand for increased fuel economy. Since 1974 at GM, more than $10 billion has been spent in redesigning our entire U.S. product line. As a result, we have more than doubled the average fuel economy of our fleet. Our efforts in this area continue along with our dedication to achieving needed improvements in quality, productivity, and cost.

In fact, GM is now over halfway through a 5 year, $40 billion capital improvement program that will extend through 1984. This program is designed to upgrade or rebuild most of our GM facilities, to make further improvements on our products, and to modernize industrial tools and processes.

Nearly all of GM's assembly facilities in the United States will be either new or significantly modernized by 1985.

But there does remain a problem at the lower end of the product line. At present we have a substantial cost disadvantage in producing such cars in the United States. This cost handicap threatens to undermine our objectives, our distribution organization, and our overall competitive position.

As you know, all American car companies have entered into new relationships with foreign companies. Competitive economics at the lower end of product offerings have made such moves mandatory. To this end, we have entered into an agreement with Isuzu to import a small car. We have owned a 34-percent interest in Isuzu Motors for more than 10 years and have arrangements with them on product programs for world markets. We are also negotiating to import a small car from Suzuki Motors, Ltd. This car would be smaller than any car currently produced in the United States.

We are currently talking with Toyota about the joint manufacture in this country of another small car. These arrangements with foreign companies will assure that American auto manufacturers retain a strong and competitive presence in this growing segment of the industry.

Working with foreign producers on smaller vehicles for the U.S. market is not a new idea. On previous occasions other domestic firms have temporarily supplemented their car offerings with imported vehicles as we did with our LUV trucks from Isuzu.

Another response from management is the improvement in our management structure. We are streamlining our lines of supervision and have improved management productivity dramatically.

Second, as to those problems involving both GM and labor, we are diligently seeking to reduce our labor costs. Our contract signed with the UAW in March is slowing the rate of increase in hourly wages and benefits, improving productivity by reducing pay for time not worked, and is providing for easing of restrictive work practices through local negotiations.

Even more important, though, the UAW contract has initiated significant changes in the union/management relationship. It has moved us in a new direction—away from confrontation and toward cooperation, away from our adversarial past and toward a new alliance aimed at the future.

In today's more sophisticated environment of worldwide competition, both labor and management know that the best way to move forward is together. In working toward that goal of cooperative progress, the agreement between the United Auto Workers and General Motors is an agreement for the future. It brings GM management and GM employees together in a united effort to meet and overcome the competition. Like our widely acclaimed quality of work life programs, it seeks to unleash the creative energies of all our employees.

However, the full benefit of progress in this critical area could take years to achieve. The recent contract, although an important first step, will not substantially narrow the existing labor/cost differential with the Japanese.

Third, we have the external problems—basically problems that we, as a corporation, cannot solve on our own. The lead must be taken by our Government and other governments involved in our trade problems.

The greatest single contribution the U.S. Government can make to strengthen American competitiveness is to provide the policies that lead to a stronger and more stable economy.

The record high interest rates we have all had to contend with have been devastating to American industry—particularly the automotive and construction industries.

These rates have now tempered somewhat, as I mentioned. But the specter of increasing budget deficits, and the obstacles they pose to maintaining an anti-inflationary monetary policy without diverting badly needed funds away from private investment, continue to cause concern in financial markets.

The only solution is an ongoing effort to reduce Government spending, and thus to find the most appropriate mix of fiscal and monetary policies that will successfully keep both inflation and interest rates on a downward trend. And we must intensify the efforts to reduce the costly burden of Federal regulation.

Beyond the problems which business, labor, and Government must address, there are other factors influencing our competitive position with the Japanese. One of these is the impact of the rate of exchange of the dollar and the yen.

The current rate of exchange gives the Japanese an enormous advantage in the American market. The yen has depreciated since 1980 by approximately 30 percent—from about 200 to the dollar to the 265 level at present—and is clearly now undervalued.

While we are trying to close the cost gap between American- and Japanese-built cars, the excessive depreciation of the yen gives Japan an increasing cost advantage that cannot be overcome by actions taken by our industry alone.

Since the disparity in financial conditions which affects currency values depends on government policies in both countries, it is in order to consider adjustment of the relevant government policies contributing to the present exchange rate distortion. In this area, as in others, the Federal Government has a fundamental responsibility.

The reason the yen stays at a low price, vis-a-vis the dollar, requires urgent study.

I have written to Treasury Secretary Donald Regan urging a comprehensive analysis of the factors that have contributed to the serious undervaluation of the yen. This analysis should go beyond the position that absence of central bank intervention indicates market equilibrium.

It should include public policies both in Japan and this country that affect short and long-term forces which determine exchange rates. Investment patterns in both the public and private sector are affected by these policies and these, in turn, affect capital flows.

Similarly, the integration of the Japanese and world financial markets would have important effects.

The Japanese program of voluntary restraint in automobile exports showed the world that the Japanese Government is aware of the problems caused by its position in the American market. It also showed an awareness of the growing protectionist sentiment in the United States and the need to act to avoid ill-considered protectionist legislation.

If some further action is deemed necessary, it would be preferable that the U.S. Government urge the Japanese Government to continue the voluntary restraints. U.S. Trade Representative William Brock has been quoted as saying:

> The agreement will have to be extended. It has worked, but our economy has not. There has been no surge in sales because of high interest rates. You can't blame the agreement for the absence of any tangible result.

As to the concept of domestic production, General Motors supports the principle that manufacturers have an obligation to provide jobs, pay taxes, and support the economy of the market in which they sell.

General Motors has based its operations throughout the world on this very principle for decades. I believe that, over the longer run, no alternative policy can prevail if there is to be fairness and balance among the major trading nations of the world.

We also note that a more realistic exchange rate would reduce Japan's incentive to export cars to the United States and provide the incentive for them to produce in the United States.

General Motors supports the principle of domestic production and sales, but I do not believe that legislation is the best way to achieve the objectives we all seek.

Legislation is often inflexible and unpredictable in its results. We support the testimony of the Motor Vehicle Manufacturers Association last March which makes the point that:

> * * * while there is increasing controversy over United States/Japanese automotive trade, concepts such as domestic content requirements raise serious questions regarding the feasibility of implementing them, the possible adverse impacts on U.S. producers and consumers, and the broader ramifications for U.S. international competitiveness and the structure of the world trading system.

We believe that Government's role is best defined as that which makes the U.S. economy strong and stable—and therefore an advantageous location for production.

In conclusion, I am sympathetic to the objective of the legislation, that is, to strengthen the American auto industry and increase American jobs, but I do not agree that legislation is the best means of reaching that objective.

The difficulties of our industry will not be resolved in legislative halls, but rather in a free marketplace where we earn our success by offering superior products at competitive prices.

That is the continuing objective of General Motors, and we have committed our resources to its achievement, and with the help of our Government and our employees, we will succeed.

Mr. Chairman, that concludes my formal statement, but I would like to add a few additional words.

First, let me say that the hearings that you are holding on H.R. 5133 have served a very useful purpose. They have succeeded in focusing the attention of everyone on the problems facing our industry. I want to compliment you, Mr. Chairman, and the entire committee, for providing a serious, deliberative forum for a full hearing of all the issues involved in this complex and, of course, very important matter.

The record of this hearing will be a valuable resource for anyone who wants to seriously examine the problems of our industry. Obviously, we in management and labor have been well focused before this, but the hearings have helped broaden the context in which our problem must be viewed.

I hope they will also serve to make the Congress and the Government at large more aware of the need to get on with meeting their responsibilities.

Certainly, the hearings will demonstrate to our Japanese friends the imminent dangers to the international trading system that exist and the need to take action to relieve those dangers.

Douglas Fraser said the other day before this very committee that the major responsibility falls on the industry itself and on labor to take resolute action.

I would like to conclude my remarks by assuring you, Mr. Chairman, and this committee, that we at General Motors are totally committed to taking the actions necessary to bring about a healthy, vigorous, competitive auto industry, a U.S. automobile industry which will provide good jobs for Americans and the kind of high quality products that the American consumer demands.

What we are doing and will be doing requires flexibility, innovation and a willingness to change. No doubt there will be controversies, but we will persevere.

Mr. Chairman, I am confident that we will succeed.

Thank you very much.

Chairman **Gibbons**. Thank you, Mr. Smith. I appreciate particularly the last part of the statement.

I think that while these hearings have been a little bitter at times, and I have expressed myself very directly about the problems that we face, I think we all have learned—I certainly have learned.

I want to talk first of all about your problem with the Japanese yen. This is a problem that has haunted the chairman for some time.

Back in July, I contacted—or June—Secretary Regan by mail and asked him to conduct a study about the yen. I have not received the results of it yet.

We have also asked the General Accounting Office to conduct a study about it.

Before this hearing is completed, even this week, we plan to have people who have followed this matter for some time come in here and try to educate us about it.

Mr. Frenzel has suggested that perhaps during the lame duck session we ought to go into the matter even further. Well, we are interested in finding every expert that we can on the matter. I have asked a number of witnesses, do they think the Japanese are manipulating the yen; their response was well, you won't find a man with a dark cloak and a black hat manipulating the yen, but it is just an endemic problem. It is like the problem that we have seen so often with—referred to as being the Japanese problem in manufacturing, but, as I recall, you come from the finacial side of the business.

What do you think is causing this vast difference between what we think the real value of the yen is and its traded value?

Mr. **Smith**. I have to tell you we have had many, many long and serious discussions about that, not only within our own corporation, but with the so-called international monetary experts.

Quite frankly, some of it defies normal explanation. For example, the drop in the prime rate in the United States should have moved significantly the valuation between the yen and the dollar, but it just did not.

It is things like that that perplex us and, much the same as you have, Mr. Chairman, has driven us to seek help from the experts and that is why we think it is so vital that we get Secretary Regan of the Treasury to get his people and their expertise in this to find it out.

It is amazing, because the effects of it are so real in the marketplace. There is just no doubt about that. Not only here in the United States, but in all of the other countries around the world where we compete for exports against the Japanese. It is something that we just have to get a better handle on and understand the fundamentals and try to find some solution for it because it is not only presenting a problem to the United States, but I think to all of the Japanese trading partners.

It is not confined to the United States alone. There are disparities between the Japanese yen and other foreign currencies as well, but we see them perhaps more vividly here in the United States in looking at our own marketing and trading with the Japanese.

It is also very important to General Motors in our export markets where we try to compete with the Japanese, because it manifests itself in price competition very severely as we strive for exports which this country obviously is very dependent upon.

Chairman GIBBONS. Do you feel the Japanese are manipulating the currency?

Mr. SMITH. I rely upon the experts just as you do who say there is no visible evidence. I think I would feel better if there were some evidence. Then you might have an explanation for the problem and it might be easier to solve.

As you said, we have seen no evidence of that, nor do we get reports of it from any of the people that we know in the international markets with which we deal.

Chairman GIBBONS. In your testimony, while you mentioned you didn't think we ought to solve this by a legislative act, which, of course, I heartily approve, let me ask you, have you looked at what this will do to the Canadian-United States auto agreement from a General Motors point of view?

Mr. SMITH. We had some very serious concerns about that. The United States and the Canadian economies are linked very closely together. There is almost a nonexistent border there which is very good, I think. The Canadians have been good friends of the United States and vice versa. We would be seriously concerned about any legislation that would upset the Canadian-United States automotive trade agreement that has worked in the past.

I think the agreement has resolved some potentially significant trading problems between the United States and Canada. I would be very concerned about any legislation that ended that agreement and brought new factors into the market because I am sure, literally, we would have to start all over again in our relationships with the Canadian trading partners if we did that. There have been large investments made on both sides of the border in support of that agreement. We have come to a good accommodation.

So I would not be in favor of anything that would upset that.

Chairman GIBBONS. While in the other committee there seems to be general consensus that General Motors could meet the content requirement of the legislation, there has been brought out by some witnesses—perhaps you all have looked at it too—the added costs and the added problems that would be placed upon you as a business just to do the tracing of domestic content.

Could you elaborate on that? Have you looked at that closely?

Mr. SMITH. We have not made an in-depth study of it, but just knowing what our experience is on Government regulations and the cost of doing that, let me say that the automobile has something like 15,000 parts. Most importantly, more than 50 percent of every dollar that General Motors takes in goes out to our suppliers.

So, tracing the ancestry of parts to determine the content could be, for us, an extremely important and expensive computation.

I can tell you, based on my experience with the Government regulations, that whatever starts out to be, at least on the surface a sometimes simple undertaking, turns out to be a nightmare, by the time we file everything in quadruplicate and get it audited by our independent public accountants.

I can give you one example of that: The emissions certifications for our cars for the 50,000 mile and the other certifications. I saw a statistic the other day that said a single copy of the papers filed in connection with a year's certification of our vehicles, a single copy, is as tall as a 15 story building.

You can see that there are monumental costs in that. As a matter of fact, the cost to General Motors of complying with Government regulations in the last year exceeded $2 billion. This is not for parts or anything that went on the car. That is the paperwork and other things that were necessary for us to do.

So we are anxious to reduce paperwork, not increase it, because again, all of those costs have to be absorbed and they place us in a noncompetitive position as we try to export, as we compete against people that do not have the cost burden of excessive Government regulation.

Chairman GIBBONS. One of the complaints we have heard at this set of hearings is that while the United States only requires dealer certification or manufacturer certification for compliance with our laws on imports, the Japanese require individual inspection of every vehicle by their department of transportation and their environmental safety departments.

Would you expect if things change in a favorable manner that you would ever be in the business of exporting cars to Japan?

Mr. SMITH. We certainly hope so. We believe our products right now are fully competitive. Certainly, there will be a limited market for our [illegible]er sized cars. As we have come into the smaller sized cars [illegible] more competitive in the Japanese market, we do believe [illegible]k cars like our new Camaro and Firebird are selling well in [illegible] overseas markets, so they are doing very well in Europe [illegible]ces where people are conscious of style and quality.

We [illegible] would be a good market for those cars in Japan, but, unfortunately, between the nontariff trade barriers and the other problems we have shipping into Japan, I do not believe we are going to be in a position to penetrate that market for some time.

Chairman GIBBONS. You mentioned a number of places in your testimony about the problem you have with cost. I have been very stringent, very strong in saying that America just cannot afford the cost of a new car now.

We have a car that is produced by very high paid management, probably the highest paid management in the world, and by very high paid labor, the second highest paid labor in the world.

The rest of us, with labor running 70 percent more in the automobile industry than it does in the average American manufacturing job, we just have priced ourselves right out of our market, or out of our pocketbooks.

What is your response to that?

Mr. SMITH. Unfortunately, labor costs do not determine the price of the automobiles. The price of the automobile is determined in the marketplace. Regardless of what the true labor cost is, we are limited in our prices by what the competition provides.

I would go back and say that while it may have been true in the past that management in the automobile industry has enjoyed a very high standing, I think that the last survey I looked at last year showed that there were no automobile salaries or compensation in the top 300 of the list that some of the magazines published.

That is because a very high degree of our compensation is based on what we are able to earn for our stockholders. I happen to believe in that system—that if we do not produce the results, you shouldn't receive the rewards.

We would like some day to return to the top of that list, but that is not in the cards for right today.

Chairman GIBBONS. What impact has all of this had upon your management system? I noticed your annual reports said you streamlined the management. What has actually happened?

Mr. SMITH. We have reorganized our organizational structure. Over the peak from 1979 until now we are operating with approximately 23,000 less salaried employees than we had formerly. There has been no end to the depths that we have gone to to improve our efficiency, and I think it is showing some results not only in the salaries, but also with the cooperation of our hourly employees.

In 1980, for example, our corporation sustained a loss of $2.65 a share. In 1981, we earned $1.07 a share, or about a $3.72 swing.

Now the important thing is, we did that on lower volume. We did tighten our belts. We have taken drastic measures, and the reason that the measures are more drastic than they appear on the surface, is that we have done this all at a time when we were investing very heavily in capital and expense money to bring out new product programs, to change our manufacturing facilities, to get more streamlined in every area of our business and keep our own research and development.

We cannot afford to fall behind in that area. It has been a tremendous burden, but at the same time I think it shows what we have been able to do, both in our salary and hourly work force.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. Smith, I appreciate your testimony. I thought you would never get to the last page.

We believe also that these hearings were necessary. The previous committee of jurisdiction held only short hearings, a couple of hours, I guess, with only the advocates of the proposal before them. I think these hearings have given the world—certainly this end of the world a little different view of reality than that which is being painted at these hearings.

We are finding much that we did not know about. We are finding that the level of enthusiasm for this bill is pretty restricted. It is intense, but it is very narrow. We are finding some other things that we need to do such as the things that you have pointed out to us today.

We think it is a plus too. I hope we will be able to make things move around.

In your first page you indicate that high interest rates pose a particular problem. I don't think anybody would disagree with that.

On the other hand, for the auto buyer, I think he has had the smallest basic increase of literally any borrower in the marketplace, isn't that true?

Mr. **Smith**. In some respects that is right.

Now we have, in our own defense, had to spend considerable amounts of our corporate funds to provide interest financing at a lower rate because we just were not selling our products in the market. So, through sales campaigns we did provide buyers of cars a 12.8-percent financing rate when the market was up in the area of 16 or 17.

Mr. **Frenzel**. But I was paying 12.8 simple 15 years ago?

Mr. **Smith**. That is right.

Mr. **Frenzel**. That is not an increase at all.

I guess the point I am making is that I think it is the principle price of the car, which has become troublesome. I was telling Mr. Caldwell the other day that I am still driving my 1971 American car, and I am a big part of the problem. That car, to me, has only one advantage: It is paid for. One of the things that we worried about here is how do our constituents who are getting the average wage in manufacturing in America buy a car that is produced by those who are doing so much better. It is not only their ability to buy the car, it is their willingness and their sense of fairness about the price of that car.

Do you have some thoughts on that?

Mr. **Smith**. I think, of course, you are right on one of our central pricing themes for the 1983 model year. On over half of the General Motors cars for the 1983 model year we have either reduced or frozen them at last year's prices. Some of our price reductions ran up as high as $1,500 to $2,000. On the lower end, we have taken around $500 off the car prices just to stimulate the demand in response to where the market is, a market I might say which is expressing to us quite the same thing you are saying.

Mr. **Frenzel**. You indicate that while American volume was down 14 percent, imports—and you say excluding those from Japan—experienced a drop of 25 percent. What were the figures on the Japanese?

Mr. **Smith**. I think, if I recall, they were down about 9 percent.

Mr. **Frenzel**. So we still have a little work to do there yet?

Mr. **Smith**. We do, but my point was, given a fair shot at them, we can beat them head to head in the market.

Mr. **Frenzel**. I assume your point was the dollar-mark relationship was OK but the dollar-yen relationship was screwed up?

Mr. **Smith**. I don't know if OK is the right word, but it certainly wasn't as severe.

Mr. **Frenzel**. As we understand, it appears to be certainly more of a market rate?

Mr. **Smith**. Yes.

Mr. **Frenzel**. Are those in dollars or units, sir?

Mr. **Smith**. Those are in units.

Mr. **Frenzel**. So in dollars it might be doing a little better?

Mr. **Smith**. Yes, sir.

Mr. **Frenzel**. Your talk of your cooperative manufacturing and marketing with foreign builders leads me to question whether you can, under your current production and your current, at least, intermediate term plans meet the requirements of the bill that this committee is hearing now. If you intergrate these foreign-produced items into your product line, are you going to be able to make the 90 percent?

Mr. SMITH. We haven't studied it in that regard mainly because some of these things were actually done before the bill even surfaced. I would say this: What we are talking about in terms of volume will be reasonably—rather fairly—low. I would not think, at least the way I understand the ramifications of the bill, that those would be any problem under the bill.

Mr. FRENZEL. Thank you very much.

About your statement about those arrangements you have with the Japanese, in the past this committee's and American policy has been to go over to the Japanese and say,

> Japanese, build some plants in our country and manufacture for our market in the United States, do it not only with your production and assembly, but also with your parts.

Your actions would seem to indicate that you feel it's better for you to be the buyer of Japanese cars; maybe that eases some of their nervousness about coming into a little different market situation, and a little different production and labor situation than they are used to. Maybe you will help that thing along. Is that your intention or how do you—you see that, do you see that keeping the Japanese out of our market for production?

Mr. SMITH. No. Let me say this: The volumes we are talking about were so small they would not provide the economy of scale. I think this is an entirely different situation. We are talking, for example, in the case of Suzuki, a car much smaller than anybody in the United States has made or probably ever will make here. It's a very, very small car. At the same time, we want to protect that lower end of the market for our dealers and particularly, as you said, very, very low-priced cars to make sure that we start the people off by getting them in a GM dealership, because there is quite a bit of loyalty from first-car buyers on through.

We would like to establish that. But, again, what we are talking about is really completely apart from anything involved in the domestic versus foreign build because of the low-volumes.

In the case of the Toyota agreement, it is different. That is because we have an empty plant—several empty plants—right now in California. We thought this would provide an opportunity to put some unemployed General Motors workers back to work here in the United States and be in a leadership position and maybe the Toyota people would come in and experience what it is to build here in the United States. I think that should provide U.S. jobs, if we can do that.

Mr. FRENZEL. We have been trying to encourage that too. You said you would have difficulty in the short run in merchandising cars in Japan. How about your trucks?

Mr. SMITH. We have about the same problem there. We have, again, the problems of the nontariff trade barriers. There are a lot of things that apply, pieces that can only be put on under Japanese supervision, the things that you referred to. We let them self-certify here for the United States, but we have to certify.

You stated all of those, all the mechanics, the differences in how taxes are assessed. There is a whole host of items.

Mr. FRENZEL. There are. We have been very critical about that. We have been through your amoligation plant and seen the difficulties, the mufflers, the light leaks.

On the other hand, we have been critical about your unwillingness to merchandise cars created for the Japanese market. It isn't quite like the American market. The side of the car you put the wheel on is only an example, because it's obvious, but there are other things like front seat and back seat, comforts, gewgaws, gimcracks, size, and so forth.

It has struck me, we are merchanding curiosities over there for a prestige buyer, but we have never made a real effort to get into that market. Your position is still that it has been the standards and the nontariff barriers that keep you from making a real promotion there?

Mr. SMITH. I think if you compare a Japanese car sold in the United States, the price is about 110 percent of the same car sold in Japan, but a U.S. equivalent car sold in Japan is priced up to about 200 percent. That gives you some idea, just as you were talking about price, what the difficulty is to start with.

We do have what we call world car programs. The J-car we make here in the United States is also made in Australia, England, Germany, South Africa, and all over the world. We will be producing it right in Japan. We know how to meet that market: Left-hand drive, right-hand drive, whatever it takes in terms of seats. We can meet that. We couldn't have maybe 10 years ago, but we can and do do it now. We will have fully competitive products in Japan.

Mr. FRENZEL. Thank you. That is encouraging. I think the most encouraging thing is your description of the new contract with the UAW. Mr. Caldwell and Mr. Fraser spoke of those contracts in the same way. If we get to a point where we are getting together instead of getting separate, that will be a wonderful thing.

Again, back to the yen. That has been a factor mentioned in nearly every piece of testimony from every witness whose business had anything to do with it before us. We have heard these allegations in Europe, of course, long before we began to make them. They are made more stridently and more vigorously there from our European friends.

We have the same stunning lack of evidence as we find ourselves. I want to say, as the chairman said, and I am sure the others will say the same thing, we are going to proceed with that as directly as we can. But we have very few clues in this game. So we will do the best we can with what little we have.

Again, thank you very much for coming in. I know your time schedule. Yet I want to repeat what I said at the beginning. I think it really is important that we get these matters out for discussion and that the public and the Congress have an idea what is really at stake here.

I congratulate you for the progress that you have made since that disastrous year. I hope your hourly employees and your management employees can be at the top of the salary heap and still produce competitive cars in a growing economy.

Thank you.

Mr. Smith. Thank you, sir. I would say that not all bad things happen without some good things. The one thing really that maybe the foreign competition has given us in the labor area, it has done something for us that we could not do, even for ourselves. That is generate this new spirit of cooperation. We are very delighted to see what is going on with our employees. It is our No. 1 key to productivity and quality.

Mr. Frenzel. Thank you.

Chairman Gibbons. Mr. Bailey.

Mr. Bailey. Thank you very much.

Mr. Smith, it has been said it's a very strange form of conceit wherein some of us hold ourselves responsible for everything that happens in the world all around us. I personally want to say this to you: There has been a great deal of discussion, and it has been rather consistent, concerning management costs, labor wage rates, and what not.

I think your industry has had a tendency to attract very, very highly paid management because I know it's very competitive. I know the management fight is very competitive. I also know you have—if you want to take this as a compliment—it's a tentative one—the industry has a tendency to attract the best and the brightest. One might say there is somewhat of a free market that operates there also.

As far as labor costs are concerned, the automobile industry in the United States is roughly comparable to Europe, if you look at the overall package. It varies from place to place, roughly speaking. It's hard to compare sometimes.

Incidentally, if I could ask a personal question—please don't answer if you don't want to now—do you own your home or rent your own home?

Mr. Smith. With the help of a mortgage, I own my own home. I guess I have to say, the bank and I own it.

Mr. Bailey. Without going further, I want to say when we talk about comparing management costs in the United States and Japan, for example, I think we have to be very careful. We have to look at certain things that the company is allowed to do for you over there that the company is not allowed to do for you here.

You have to look at a different personal income tax structure, et cetera, et cetera. I think sometimes when we take a great issue and reduce it to a comparison in that area, I think it can be overdone sometimes.

Incidentally, I also want to say—and I think this is a point the chairman has made consistently, and I think correctly—or he at least has hinted at it—the competition doesn't hurt us a darned bit. Apparently you have done reappraisal, management efficiency analysis, that kind of thing. You feel the competition in that sense has been beneficial, I gather?

Mr. Smith. There have certainly been great beneficial effects from the competition. We are not concerned with competition as long as it is fair competition and free competition. There you get into semantics and definitions, too. We have made great studies, Mr. Bailey, of the Japanese system of cost. As I say, owning 34 percent of Isuzu, as we have for 10 years, we are familiar with all their compensation cost.

Mr. **Bailey**. I wasn't trying to draw you out but I am glad you said what you just said. I would like to take it further, if possible.

Talking about fair and free and all things being equal and references like that, I happen to be one of those who believes that when you were producing automobiles for the American market while we had, some say, artificially—partially that is true—but in any event, while we were enjoying very low petroleum prices, I think you were building automobiles for what Americans wanted to buy.

I can remember my father bought the first new car of his life in 1966. We wouldn't have dreamed of buying what was considered to be an unsafe, small, foreign car, period. I think the best explanation for the situation we find ourselves in, which was an extremely high conversion cost that hit—fell like a guillotine on the industry, on our economy as a whole, and subjected us to pressures from countries who had a great deal of experience and knowledge in small-car manufacturing and marketing.

In short, I guess what I am saying is if gasoline were still 30, 40 cents a gallon, I think you would still be producing those larger cars, and I think people would still be buying them.

Mr. **Smith**. I think there is no question the acceleration of gasoline prices from the area of 37 cents to the current levels has had a dramatic effect. I also think the problem of the stability of supply has also been a large factor.

Mr. **Bailey**. Don't you control world oil prices?

Mr. **Smith**. No, sir.

Mr. **Bailey**. Well, why not?

Mr. **Smith**. That is a market in which we have no factor.

Mr. **Bailey**. This conversion that you are going through, this technology conversion you are going through, the reindustrialization, do you feel that it is proceeding at a satisfactory rate? Are you satisfied with the progress in that area?

Mr. **Smith**. I don't think you can ever say you are satisfied with the progress; you would like to make more. I will say this—I know we have made giant steps. For example, I think as far as General Motors has gone in robotics is an outstanding example. We do have the technology in the United States to really win this battle.

Mr. **Bailey**. I talked to folks at Carnegie-Mellon in Pittsburgh where some of that technology was developed and licensed and sold overseas.

I for one want to compliment you. I think the industry and labor have done an absolutely fantastic job. I think someday when the history of this thing is written that it has been a monumental effort, a tribute to free enterprise, a tribute to responsibility. As a collective group, I would like to compliment all of you. I think it has been fantastic.

I think once we get out of the woods so that we can see with a little perspective, we are going to realize that you people have—and somebody needs to tell you this, somebody needs to publicly say to you they are proud of you and that labor and management, you have done a terrific job in responding to this problem.

Quite frankly, if the Government's record were as good, I would be happier, but I don't think it has been. That is my personal view. I want to say that to you on the public record.

Mr. **Smith**. Thank you very much, Mr. Bailey.

Mr. **Bailey**. Now let's talk about some of the causes. Mr. Fox of the National Association of Manufacturers was here yesterday. While you responded to the chairman saying there was no evidence of manipulation with the Japanese yen, he was talking about the difficulty of investing there, difficulty of more borrowing, the difficulty with marketing. All those things have come out.

If—and this is a very tenuous hypothetical, and I do not have the expertise to answer it, I hope you do—if the Japanese system, hypothetically speaking, were as open as ours, if you were as free to invest in that economy or to move around in it, Mr. Fox talked about the ability, for example, to borrow money if he wanted to make an investment. He said you try to get one, two, three loans and you are lucky if you can get that kind of money there.

It is common knowledge to talk about the difficulty of marketing there. You cannot get in there and compete, for example, in marketing techniques or sales techniques. You cannot learn about what to do there because you hit a brick wall when you try to go in.

Would there be a relationship, do you think, between currency fluctuations if that society were as open as this and, present problems?

Mr. **Smith**. Certainly, that is one of the things we hope the study will explore. I have to say it is a very unusual situation because if the Japanese, for example, were to completely open their capital markets with the rates they have, you would find a tendency for people to go to Japan and borrow money and bring it to the United States.

That would be in old-fashioned economics—just the thing you would not want the pressure to produce.

Apparently everything they do over there right now seems to defy all the textbook traditions. That is why we think it is going to take some real expert, deep, deep research, into finding out what is it that is producing these almost backward types of situations from what the true economic forces would tell you.

Mr. **Bailey**. Let me go out on a limb and postulate something. You shoot me off that limb, if you will.

Mr. Fox seemed to indicate that one of the problems, or maybe the problem with currency devaluation with the yen is that its value is perhaps partly prescribed by what has become—I read this into what he said. He did not say it outright, the best I can make of it. Take this apart. It seemed to me that what he was saying is what exists now, some of the difficulties now, can almost be ascribed to what has become common usage or practice over many, many years of Japanese policy in recognizing the export value in a devalued currency and that—I, in my own mind, sitting there, thought perhaps what we were talking about is something which has just become a part of world practice, Japanese banking practice, to the point where we are not really talking about deliberate or overt manipulation, although that will beg my next question.

But that appears to be the situation.

From what I could read through what he was saying, that seemed to be it. Everybody recognizes the problem. They do not think it is really pinned on a few fellows in a back room trying to bring a mallet down on anyone's head, but that it is more or less built into banking practices, lending practices. I don't know. Is that it?

Mr. SMITH. Let me say I agree with you and that that certainly could be an explanation. It could be part of the explanation. I don't think it is all of the explanation. Again, I think it will take learned people to get in there and deal with this and find it out.

Mr. BAILEY. You said you do not think that will be all of the explanation. That begs, as I said, my next question. If there is no evidence of manipulation, however, are there steps that the Japanese Government perhaps can, could, or should take to deal with this difficulty?

Mr. SMITH. I hope we can find some, but again I do not want to suggest for a minute that intervention by the Japanese in the exchange market is a plausible answer to that; but I do think—again that that is what I am hoping—that somebody can find out how this thing is occurring and why it is occurring and what some of the resolutions of the problem could be.

I am concerned that there may not be any short-term resolution.

Mr. BAILEY. There rarely is, I have found in my brief experience down here. Do you have any suspicions as to why? Anything you can risk saying?

Mr. SMITH. It seems to me, of course, that certainly some national policies and some differences in the way they operate their monetary and fiscal policies versus the United States may explain the root cause of this, but again, as I say, it is going to take some long-term deep study.

Mr. BAILEY. Mr. Smith, I am not suggesting that we ask the Japanese to place their economy in what they have built at risk to the benefit of the rest of the world, but I think there have been things that in terms of what this free enterprise model—and I mean that sincerely, not facetiously—I think in some ways by perturbations or severe problems in the international trading sphere, I think that model becomes endangered.

I think there is a relationship between that model and our political liberties, and so forth. Most of us agree with that. That, to me, is an ultimate value.

In short, what I am saying is, I am concerned about us always discussing free trade in a context of free market and the relationship between free market and what we do in this country and what happens abroad.

I think where I have a problem is that by the same token we have to be concerned about free trade as some sort of philosophic thing that appeals to us; we can't expect the United States to be some sort of conduit or launching pad for just giving technology away and exporting capital.

At some point we are tied together in terms of our military responsibilities worldwide, our diplomatic responsibilities, and so forth.

Tariff, trade barriers, and so forth. Why haven't you done a more aggressive job going into Japan? It seems to me you talk about building a factory in the United States, talking about Toyota coming over here.

By the way, are they going to supply some of the capital in that deal, I hope? Is that one of the major incentives?

Mr. **Smith**. Obviously.

Mr. **Bailey**. Then why if, when we are doing things differently, didn't you want to build a factory to produce and sell automobiles in Japan or build the car there to bring it back here?

Mr. **Smith**. As I say, we have explored the opportunities in all of the world markets because we have been a world company since our very, very beginning.

Let me just give you some examples. Our net contribution to the U.S. balance of payments last year was in excess of $3 billion. So you can see we are an export company. We do operate in almost all of the major countries around the world. We operate in various ways in various countries. Where we can, we have preferred to own the company ourselves because of the problem of a large company with a very complicated product places sometimes some unfair relationships on minority stockholders, if we had to make a product change in another country.

As I say, more than 10 years ago, when we were examining the Japanese market, we did consider the problem of putting a passenger car operation into that country, owned solely by us.

Mr. **Bailey**. Why didn't you do that?

Mr. **Smith**. It did not turn out to be a viable way. We therefore made an investment in a Japanese affiliate, Isuzu, and tried to grow with product produced in that market.

They were basically a truck manufacturer. We have, through arrangements with them, broadened their product line into passenger cars at the very low end. What we always have to do is see if we can go into a country and get volume on an economical scale that will provide us an economic unit. That was not possible in Japan.

Mr. **Bailey**. You wanted to go there and build a factory and sell cars there and perhaps build cars to export from there?

Mr. **Smith**. Basically I think we were looking at the Japanese market. Japan is a very, very large car market.

Mr. **Bailey**. Why didn't you do that? I want to get to why you didn't. It seems to me if you had the capital to go do it, and it sounds like a good business decision, and you view yourselves as an international company, I think the sooner the rules of the game are the same in every country around the world, the sooner we will have bills like this not being introduced as a response to other problems, which is exactly what it is.

Why didn't you build that factory?

Mr. **Smith**. As I say, at the time the economics that we could find supported a venture with a Japanese partner rather than a 100-percent ownership of a company of our own.

Mr. **Bailey**. Did it have anything to do with marketing there, cooperation, or anything like that?

Mr. **Smith**. Those were all obvious factors. I cannot at this point recall in my mind what some of the tie-breaking decisions were 10 years ago. It is not uncommon for us to operate with partners.

Mr. **Bailey**. I don't want to get you——

Mr. **Smith**. We operate in Korea, for example, with a 50-percent partner. We operate in other parts of the world with partners, too.

Mr. **Bailey**. I can conceive of business advantages to doing that. I just wondered.

You know, if a foreign manufacturer wanted to come in here and build a factory or buy one and do something on their own, it is a pretty easy thing to do.

Mr. SMITH. There is no question that the United States has the most open and free trading economy of anyplace in the world.

Mr. BAILEY. There is no doubt in your mind as an international businessman that that is true?

Mr. SMITH. I think you would find everybody in the world agrees with that.

Mr. BAILEY. Mr. Smith, that is the reason for this legislation. It is an angry response. It is not a good one.

The United Auto Workers are pushing this bill about as hard as anybody is. I have tried to build a record on this issue: Every single witness before the committee, I have tried to raise the question and make the point that it is not the best, the most ideal thing to do.

Now comes the hardest question. I have all kinds of ideas what to do with the American tax structure if I could get through with it. I have all kinds of criticisms of some things we have done, including the last tax bill. I will not pin you down on those.

What would you do? I understand you don't feel this bill is the best route to go, but quite frankly, if you look at our economy as a whole, we really, in many ways, are placing our businessmen, in my opinion, in a difficult situation because we are not giving them good legal tools to compete with foreign countries.

We don't want that relationship in terms of the planning concepts, of course. You don't want that as a businessman between your government and you.

You are up against that problem in Europe, up against it in Japan. So you have to fashion some uniquely American alternatives, it seems to me. I thought the tax code was a good way to decrease your capital costs, to spur your investment, to encourage reindustrialization, look at our antitrust laws.

Our labor people are learning what the word productive means. Incidentally, has the union ever interfered with productivity improvements or reinvestments?

Mr. SMITH. Let me say, right in the preamble of our agreement with the union—and it has been there for as long as I can remember—is a mutual recognition of the need for productivity increases, and the union has been most cooperative in that regard.

Whenever we can come up with an idea that increases quality and productivity, we have not had any problem with the union implementing that.

Mr. BAILEY. What you are telling us, Mr. Smith, is that the union is not—they are not featherbedders? They have not tried to——

Mr. SMITH. Let me say there is a difference between featherbedding and productivity improvements. I hope I made it clear one of the great steps that I think came out of our last national agreement was the elimination of some of the pay for time not worked, which was hurting all of our economies, and hurting, in particular, our competitive position.

We still have a way to go on that.

Again, let me just say that absenteeism is a tremendous problem in our industry. We are working with the union on programs to make sure people are there. We have to carry extra people—and that is at an added cost—to make sure we can man the lines when people don't show up.

We have a good program working with the union to try to stop that, but we have a long way to go to be the Nation we need to be with competitive labor practices.

Now, I am not discouraged at all. I maintain that the U.S. workers are the best in the world. They have the intelligence, everything. What we need to do is put a system in operation for them to use that ability.

Mr. **Bailey.** I have not made much of this during these hearings because they are very difficult to evaluate, but studies do indicate with like equipment and in like situations, although it is sometimes hard to compare, that American workers are on the average more productive, better than any workers in the world.

Largely that has been partly a matter of work ethics, and it has been skill. We are worried about skill levels. We are not making the investments as we should in this country. That is a whole different policy area.

I don't know. I just want to thank you very much for the testimony. I understand your feelings about the legislation. I would just finish up with recommendations to sit back, look at the problem as a whole, because some American industries are being victimized in a sense—the same rules just do not apply.

I would hope you would maybe get some of your staff to give you a summary or, if you have the time to read the petition in the Houdaille Machinery petition that was done. I have studied it. I know the special trade representative, Mr. Brock, has because when I questioned him before the committee last week or so, when I made reference to it, he knew what I was talking about.

I wish every international businessman in the country would read it because I think it would help us create a good public dialog.

Thank you again. I will finish once more with a compliment I have for the changes you folks have been able to make. I think when it is all said and done you will be very, very competitive. I hope the Japanese will. I am sure they will.

I hope there is enough room to do business in a fair way all around the world. I really think they do have to open up their system. That is why this piece of legislation you don't like is here. There is a public reaction, an angry one.

Unfortunately I think in many ways it is justified.

Again, thank you very much. Thank you, Mr. Chairman.

Chairman **Gibbons.** Mr. Smith, in response to a question that Mr. Bailey asked you, let me say the United States is the most open market in the world. Do you think that is good for the United States?

Mr. **Smith.** It certainly has had its benefits in providing the United States consumer with the widest array of goods at probably the lowest possible price.

Again, as I say, those are some of the things we have to continually watch to make sure we do stay competitive, and that the rules of trade are maintained on a fair basis. That is why we have GATT discussions and that is why we must always continue to monitor and keep the pipelines open and keep the trade flowing.

The United States is a net exporter. We would certainly have more to lose in any trade wars than we would have to gain, I would think.

Chairman **Gibbons**. Are you generally satisfied with our trade laws?

Mr. **Smith**. I guess that is a difficult question to answer. It is always as compared with what you think they should be; but again, we have to be considerate of the national aspirations and desires of our trading partners and understand what our position is.

As I say, we at General Motors have been a net exporter. I think one of the reasons we have been, is that we have been scrupulously honest and free and fair in our trading and have tried to be a good citizen in every country in which we operate.

I suppose we could have pursued a policy of building solely in the United States and exporting only to other countries, but I think that would have been very shortsighted.

I think over the long run it has proved very beneficial. We have created a lot of ability to export.

Chairman **Gibbons**. Before Mr. Brodhead comes on, I want to say we are going to miss him. He is retiring voluntarily from the Congress to return to his home town and your home town. He has been a fine Member of this Congress.

Mr. **Brodhead**. Thank you, Mr. Chairman.

Mr. Smith, I was going to allude to the point you just made with the Chairman. I am very much impressed with your statement on page eight where you say General Motors supports the principle that manufacturers have an obligation to provide jobs, pay taxes, and support the economy of the market in which they sell.

Certainly, as you state, General Motors has followed this principle and followed it scrupulously and successfully.

I think the reason that we are here today—why we are considering this legislation—is that other manufacturers have taken a different view. I wanted to ask you, on page four you refer to some of the efforts that general Motors is making to work with some of the Japanese manufacturers, and you refer to your agreement with Isuzu, the negotiations to import a small car from Suzuki Motors and the discussions with Toyota.

What do you envision in light of those efforts that you are making? What do you envision for the future in terms of the number of people that General Motors will be employing in the United States?

Obviously there are other factors that go into it, but other factors aside. How are these discussions going to impact on the number of people that General Motors employs within the United States?

Mr. **Smith**. I think it will have a positive effect on that.

First of all, you have to understand that we hope—and I sincerely believe we will have local content—U.S. local content—in these imported cars. We know right now, for example, that to meet the emission laws of the United States, these cars will probably use the General Motors system. We have the most complex, but the best emission control system in the world with our electronic system.

We are, through our Delco Electronics Division, the largest manufacturer of some electrical components in the whole world. We have great expertise.

To bring those cars into this market, they will come in with perhaps our catalytic converters on them, our electronic ignition system. What I say is, I hope those will create jobs for Americans as opposed to the fact if we didn't do this and those cars come in from other manufacturers with no U.S. content on them, of our manufacture or anybody's, we will have a positive effect on that.

Down the road, in the long term, there is no question but that we intend to have a car in most of the size areas—I don't know if we ourselves will ever make one as small as the Suzuki, because I do not believe that market will grow to the size to make it economically viable, but we do not intend to abdicate that market.

We know we have to have a product down there. We need it for our dealers and for our customers. What we need to do is get some time so we can come up with an entirely new product and an entirely new manufacturing system.

We know very well we cannot be cost effective with our current product and our current factories. We have people right now working very hard to determine the optimum way to build a car that size. We know it is going to take a major technological advance to do that over and above where we are now.

We know we have to do it. I am confident we will do it.

Mr. **Brodhead**. Mr. Smith, you had some reference in your prepared remarks to the problem of the depreciation of the yen as against the dollar.

If this problem were solved, if the yen were fairly valued, how would that impact on General Motors' ability to compete with Japanese manufacturers?

Mr. **Smith**. It is not going to be the end of the problem, but it certainly is a major portion of the problem right now. The problem we face is very complex and it requires a multiple solution. Some of the things, like the yen, I believe can be solved.

It may take a little bit of time. Other steps that we are taking right now are going to help us. There are some factors in our cost differential that we will never solve.

Geography—for example, our Japanese affiliate over there does not have a supplier more than 60 miles from a plant.

In the United States, I sometimes think we do not have any within 60 miles, but we work very hard on it.

In adapting to the Japanese systems, there are some expensive lessons to be learned. We are working very, very hard on what is called the just-in-time inventory system, which means you lower your inventory costs and you can achieve great efficiency.

They sometimes receive material eight times a day for their production. We have taken enormous strides in that respect; but let me give you an example: during the railroad strike, as brief as it was, we had factories that had to shut down the first day.

You cannot operate in this country with that type system as successfully as you can in Japan, if you are going to have railroad strikes. The penalty can wipe out all the gains within a week. We have to balance our national desires and national characteristics against the optimum system and try to do the best we can.

Again, I think that is a job of management.

On the other side of the equation, let me say this: We can, with our technology, make tremendous advances. You talked about the television sets. We produce radios in the United States for our cars because we think we can make the best quality radio at the lowest price right here in the United States.

We have done that with tremendous technology advances. We do have great technological leadership. We had to organize it better; we had to make the tremendous investments to do it.

Robots, I think we have the finest painting system for cars in the world today in our new numerically controlled robot painters. It has taken us a long time to develop it, but we will produce a car that will have the finest paint system on it of any car in the world.

We have done it with American technology.

Mr. **Brodhead**. Thank you, Mr. Smith.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Smith, your ordeal is about over.

Let me ask you a few more questions though.

The light truck industry that you mentioned, you pointed out the progress you are making in that area has been under a protective tariff of 25 percent for about 20 years, as I recall now.

I must admit that the Japanese were able to get around it by shipping parts over here in rather large pieces; but how much longer will the auto industry or the light truck part of the industry need a 25-percent protective tariff?

Mr. **Smith**. I think the answer again is tied up with how much longer will the Japanese depreciation on the yen continue.

If you look, the depreciation, the excess depreciation of the yen has more than compensated for the truck tariffs.

I think you can see that in the marketplaces, where at the end the consumer, the purchase on that, when the tariff was imposed, the trading prices on the trucks varied very little. It showed the tremendous advantage you can have with a depreciated yen.

Chairman **Gibbons**. How much longer do you think the voluntary restraint agreement will have to be extended in order to give you time to recover?

Mr. **Smith**. I think our recovery time—and again it will depend upon where the U.S. economy goes—I would say the faster the recovery in the economy, the faster the return we have; it can benefit all our industries to the point where we can dispense with the restraints in a short time.

If, on the other hand, you have a long slow recovery and continued unemployment, there is going to be continued pressure for some type of restraint by the Japanese.

Certainly I think the voluntary restraint and its manifestation has served that purpose.

Chairman **Gibbons**. Will 1 more year be enough?

Mr. **Smith**. I don't know I can answer it that way. I would again have to say what will be the speed of recovery in the U.S. economy?

Chairman **Gibbons**. What yen value ratio will you need in order to compete successfully with the Japanese?

Mr. **Smith**. I have heard estimates that the yen should be truly valued at anywhere from 180 to 200 to the dollar, and I think that when we reach some equilibrium where the yen is in its proper position, we should then say that the rest of the problem of competing is our own rather than anything that relates to the international markets.

Again, as I say, it is a multiple problem with multiple solutions. If we can get everybody to accept their own problems and handle them all, I do believe we can do it successfully.

Chairman GIBBONS. In response to a question that Mr. Frenzel asked, you pointed to the new spirit of cooperation with the UAW. That is something that I applaud and I am sure everyone applauds it because the long history of adversarial relationships between labor and management in this country has been a point of concern for many of us, but I worry that you may find yourself in the same boat as the American steel industry.

They made their peace with their workers, but they found that the way to keep peace was to keep raising their labor costs, and I think I was reading United States Steel's annual report a couple of years ago and they said their annual labor costs then were over $21 per hour.

Yours is around $22 to $23 an hour. I just hope in this new agreement that United States Steel found with the steelworkers that prices them completely out of the market—nobody can afford their steel any more; we can't afford it; nobody can afford it, and we have vast unemployment in that area. I just hope the same thing doesn't happen with you and the UAW.

What steps can you take to make sure that that does not happen?

Mr. SMITH. I think we are more fortunate than most industries in that the product we build is very complex. As I said, it has 15,000 parts. We can always find new ways with the help of our work force of putting a car together, changing this, redesigning this, and improving our efficiency. So we are blessed in that regard with a product that is susceptible to improvement and change.

Again, what we can achieve in improved quality which will dramatically lower costs for us, quality doesn't cost money; quality is one of the biggest cost savers that I know of. We are finding that out more and more as we do produce higher quality vehicles.

So I think there is a tremendous opportunity within our system, within our industry, to achieve cost reductions that maybe some other people simply just won't have.

So it gives an opportunity to lower our unit labor costs while at the same time increasing the actual labor rates.

Again we are dedicated to doing that, and again as you have pointed out, we have that opportunity now under our new contract like we have never had before.

Chairman GIBBONS. Is the United States—are the U.S. tax laws in any way inhibiting your competition in the world market?

Mr. SMITH. That is a very complex question.

Chairman GIBBONS. We are the tax writing committee. I figured while I had you here I better ask that question.

Mr. SMITH. Certainly it has to be studied as against international competition, where we are vis-a-vis that. I believe anything that provides a reasonable base in the United States to foster capital growth is going to be essential for the development of this country because, as we go more and more into automation and robots, capital formation is going to be very difficult not only with our industry, but with all industries.

We can never achieve the goals for America without laws that do work toward the establishment of a good capital base and provide what is necessary. So it is terribly important.

These are factors that do enter into the international markets as we have to go out and compete against other countries that may have more favorable capital laws than we have in our own country.

Not only as to where we locate our plants, here versus somewhere else, but how we compete with them for third country trade. So it is terribly important.

Chairman GIBBONS. I could go on for hours, but I will not because of my respect for your time and your patience.

Mr. Vander Jagt?

Mr. VANDER JAGT. Thank you, Mr. Chairman.

Mr. Smith, it is a pleasure to welcome you here. I apologize for not being here to hear your statement. I have had an opportunity to read it. It is an excellent one. I am glad you are here.

I am appreciative of your commitment to the goal of domestic auto production in the United States and think you outlined a number of steps that will help us reach that goal. One of the things that you suggest are some changes in Japanese policy vis-a-vis the yen and do you think that if this legislation were made discretionary rather than mandatory—in other words, the President would be given the authority to apply the trade restrictions where he finds that the other government is not cooperating with us in moving toward a fairer trade relationship—would that be an improvement in the legislation?

Mr. SMITH. Our experience in the automobile industry with discretionary legislation has not been very good. We have seen that in some of the safety and emission regulations in the uncertainty that that causes in a long leadtime industry—and ours is absolutely devastated. We have incurred multiple costs for multiple systems only to find out that sometimes only one of three systems that we have been forced to develop has ever been enacted and sometimes what has been enacted is completely different than we have prepared for.

So I would say that from our own experience, discretionary laws have not worked very well in the auto industry, again because of the tremendous investments inherent in car production and the tremendous variability and lead time that we have.

Mr. VANDER JAGT. Last week we had a witness before this subcommittee, an analyst of the consumer tastes and projecting the future. Contrary to what we have been hearing in general, he was very bullish about the future of car sales in the United States, the shift of population to the Sunbelt, 14,000 additional customers entering the market every year.

Assuming we get our economy in order, get interest rates down to where the purchase is more within reach, what is our outlook for the future of domestic production and sales?

Mr. SMITH. I think we have a tremendous future. I think again it is just exactly what you said, Mr. Vander Jagt. We do have to get the economy turned around.

But let us assume that that does happen. There is nothing that I have ever seen that has replaced the value of a car to an individual. It is one of the great freedoms we have in this country, the freedom of mobility. You can see it just in the difficult times that we have had trying to support alternate transportation modes.

People still prefer to get in their car and drive to work when they want to. They value that freedom and are willing to pay a price for it. Thank heavens we can supply that need. We, looking at our product line at General Motors and the improvements we have made in our quality, are also very bullish on this market.

We have said that if again the economy can be turned, as it seems to us to be turning now, and grow the way we think it could, in a year from now, I would hope that we can be traveling at an industry rate of about 14 million cars and trucks a year about a year from now.

I believe that we can go up from that in 1984 even higher. That is not an outlandish guess on the market when you consider as late as 1978-79, we were traveling at a 15½ million rate. Fourteen million cars and trucks wouldn't get us back to those peaks, but I will suggest that it will return a lot of people back to work.

I believe it is possible for the automobile industry, as we have done in the last two recessions, to lead this country back out by putting our people back to work.

Mr. VANDER JAGT. Thank you very much. Thank you for being here.

Mr. FRENZEL. Mr. Chairman?

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. I have just one comment and one question. The question would be, do you manufacture in countries that have local content laws?

Mr. SMITH. Yes; we do.

Mr. FRENZEL. Which ones? Brazil?

Mr. SMITH. In Brazil. I think if you look where we manufacture with local content laws, you would find in most of what I would call—and I guess are commonly called—the developing nations that are trying to nurture an infant industry, we do abide by, of course, the local content laws. That is basically where you find that type.

Mr. FRENZEL. What kind of experience do you have?

Mr. SMITH. We have had varying experience. Again, the problems in Brazil are not so much the local content law as the Brazilian rate of inflation and Brazilian interest rates and the Brazilian economy.

We did operate in Argentina until the economy told us it was time for us to get out. We had to withdraw. I hope some day we can go back to Argentina and be part of their market again. When the inflation rates got into the triple-digit area, it just meant it was uneconomical for us to stay.

Mr. FRENZEL. Other things being equal, you would prefer not to opt under a local content situation?

Mr. SMITH. Well——

Mr. FRENZEL. Retain the flexibility?

Mr. **Smith**. Obviously the flexibility of local content is not going to get you the lowest priced product. There is no question about that.

Mr. **Frenzel**. Your experience worldwide has been local content does not give the lowest price possible for the country of manufacture?

Mr. **Smith**. I think that is almost axiomatic in economic terms.

Mr. **Frenzel**. I believe it, but some of our friends don't.

I wanted also to make a comment. That was that your statement on Government regulations, although we didn't comment on it, has not gone unheard. The extra, unnecessary costs you have had to bear to expand are a national scandal. I think an awful lot of people down here recognize the problem and want to work on it with you.

I, like you, think it is going to take generations to rout out around here; but the more vigorously and sooner we get about it, the better off we will all be.

Mr. **Smith**. Thank you.

Chairman **Gibbons**. Mr. Bailey?

Mr. **Bailey**. Thank you, Mr. Chairman. I will be very brief.

As you know, Mr. Smith, nothing affects the price of that car out there more than when you look at the problems of high capital costs and the impact on productivity improvements and that kind of thing that tell over time and impair your efficiency.

The chairman made comments about the steel industry and labor costs there. I worked in the steel industry as a third helper on a specialty furnace, an open hearth furnace in the early sixties at $3 and something an hour, which wasn't bad at the time but we have done away with those systems since, or with improvements since that time.

Part of the problem is, I think, you have to operate in an environment of expectations of very high return. I think capital intensive industries, particularly sometimes, may find themselves in situations where they are talking about low profits and high investments that spread out over many, many years.

I am willing to compensate for that that we may have to face some alternatives with policy changes, taxes, et cetera; that is, putting certain people in situations where their capital costs are decreased or encourage investment through incentives and that kind of thing.

Along that line, would you possibly send suggestions. I know you are not a refundability champion. I know the word transferability makes you nervous. I know that on the safe harbor leasing provisions you were one of the companies or one of the individuals that was not supportive of that idea; but we need to find some way in this country to put you in that competitive situation to follow up on the chairman's question, because quite frankly, you are not in a competitive situation.

Another thing you said that caught my ear, and I would love to have your comments on, is you talked about apparently having to delve into your resources in order to do self-financing.

I don't know how that relates to what they do in some other countries, but I know that that is one area where subsidization of exports is obvious all around the world; something that we don't do.

I know you are going to say we shouldn't, or I assume that you would; but what remedy would put you in a competitive situation? You cannot depreciate things as fast as many countries can.

How do we——

Mr. SMITH. The study of the tax laws, as I referred to before, is extremely complex. I think the United States did make a big move here a year ago with the accelerated depreciation writeoffs and rules that came out. Again I have to say, of course, that all of this has to be budgeted and balanced within what means the Government has to live with.

The worst thing that I can think of would be great reductions in taxes for industry to promote capital growth at the expense of enormous deficits. So I think there has to be, coupled along with a favorable tax climate, has to be some care with where the budget deficits are.

My solution for that, as long as you asked for it, is to see some further reduction in Government spending to make sure that we do have a balanced economy in this country that has some stability and long-term viability in it, too, because one of the serious problems that we have in our industry today that I have not delved into is consumer confidence.

The consumer needs to know that he can go out and make a commitment on a car to make the payments over a 3-year period with some certainty he is going to have a job long enough to pay those back. I suggest that the Congress could do a great amount in helping that and stepping up to balancing some of these problems that we have on revenue and expenditures.

I think that even a sign from the Congress that it is serious about living within its means on revenue spending would be a very, very important element, not only to the financial communities but also to the average man on the street.

Mr. BAILEY. If I had to set my priorities as to the cause of that deficit and the resource allocations which give rise to it and you gave me a number of causes from which to choose, I have to be very honest with you. The top of my list would be what I consider the top priority in this country, and that is structuring means to encourage reinvestment in plant and equipment. So we just may disagree.

Mr. SMITH. I wouldn't disagree with you on that. I would agree with that. I have to say that along with that, there has to be a companion holding its hand, and that is some reasonable method of financing that by some reduction in expenditures by the Government, because I am sure, Mr. Bailey, you do not want to see an enormous defecit out there no matter what might cause it.

Mr. BAILEY. No; but there are honest differences as to its cause. One of them, Mr. Smith, is very simply the fact we have let our investment in basic plant and equipment decay in this country in some very, very important capital areas. Where it is going to show up, to give you an example, is the cost of energy. The cost of energy is going to increase in 1985 and 1990. We are going to need important technology from France for nuclear energy because we are not making proper capital investments in the utilities industry now.

There are areas private enterprise cannot deal with. Government has to solve those kinds of problems. Those are properly government issues. I agree with you. I just think we are paying the piper now for years of maybe running at high capacity and not making the reinvestment changes we should have.

I don't know. You are much more expert than I am.

Maybe my priorities would be a little different. I don't know the solution either. I sure thank you for your testimony here. It has been educational for me. I appreciate it.

Chairman GIBBONS. Mr. Smith, you have completed 1 hour and 50 minutes of testimony here. We appreciate you coming and taking a position on this important piece of legislation.

Mr. SMITH. Mr. Chairman, I was delighted to have been here. I hope I have contributed in some small way. It certainly is, as we said, a very important issue.

Thank you very much.

Chairman GIBBONS. You have contributed. Thank you.

Why don't we take a brief recess?

[Recess.]

Chairman GIBBONS. Could we reconvene, please?

Our next witness is from the National Association of Stevedores, Mr. Thomas D. Wilcox.

STATEMENT OF THOMAS D. WILCOX, EXECUTIVE DIRECTOR AND GENERAL COUNSEL, NATIONAL ASSOCIATION OF STEVEDORES

Mr. WILCOX. Welcome, Mr. Wilcox.

I apologize for keeping you waiting so long.

Mr. WILCOX. Mr. Chairman, thank you.

Mr. Chairman, members of the subcommittee, I am Thomas D. Wilcox, the executive director and general counsel of the National Association of Stevedores. We very much appreciate the opportunity to appear before you this morning to express our opposition to H.R. 5133, the so-called Fair Practices in Automotive Products Act.

The National Association of Stevedores is a trade association whose 64 privately owned member companies engage in stevedoring and marine terminal operations on all four of the Nation's seacoasts, the States of Alaska and Hawaii, and Commonwealth of Puerto Rico. NAS member companies contract to load and unload ships which call at this country's ports in both domestic and foreign commerce and employ longshore labor to accomplish those functions.

NAS member companies also furnish pier storage facilities for both exports and imports and consolidation yards for project cargoes and large shipments. For example, in the area we are discussing here of automotive products, if Caterpillar Tractor were exporting a large amount of Caterpillar tractors to a country, they would ship to our facilities, not all at the same time, but over a period of time several pieces of equipment which would be accumulated at the waterfront facility to be loaded on the ship when it arrives.

Mr. Chairman, recent Department of Commerce statistics show that over 95 percent by weight of this Nation's foreign commerce moves by ships, ships that are loaded or unloaded by NAS member companies and the American longshoremen they employ. The dollar value is less than that because the high-priced exports and imports go by air.

Enactment of H.R. 5133 or any other legislation which would impose artificial barriers to the commerce of the United States must be vigorously opposed. Such legislation is contrary to this country's commitment to free and unemcumbered trade and invites retaliation from our partners in trade worldwide. We have experienced this.

Such legislation has a direct, severe, and immediate adverse impact upon NAS member companies and their employees. It eliminates or reduces their employment. That follows immediately. To attempt to create jobs for one industry and its employees at the expense of another simply doesn't make any economic sense to us even though there are those who think it might make domestic political sense.

The stevedoring/marine terminal industry and its employees, as I said, will be the first to feel the severe impact of the implementation of H.R. 5133, or any other artificial barrier to free trade. The Department of Transportation, in a letter to Congressman Dingell dated July 16, 1982, stated that fact most explicitly, and I quote from the Department's letter:

> Unemployment in the Nation's ports would result from the loss of 1.9 to 2.9 million automobile imports: We anticipate that 7,600 to 11,600 direct jobs would be lost and 53,200 to 81,200 indirect jobs would be in jeopardy at 14 ports on the east, west and Gulf coasts.

I might insert here, NAS companies operate at each of the ports listed. They go on to list their estimate of losses by port which I do not think is necessary to read since it is in my statement, although you will note in Jacksonville, they estimate a rather large amount; in Tampa, which is newly getting into the import business, they predict some 900 to 1,300 lost jobs.

The proponents of H.R. 5133 have given no explanation or justification as to why some 11,600 longshoremen would be put out of work, or why the 81,000 port-related employees should be placed on the unemployment rolls. In truth, I believe there is none to give.

I'm sure that others will testify about the financial impact of H.R. 5133 on domestic auto prices and other related products but there is another inevitable cost impact which has to be considered.

At this point, Mr. Chairman, let me say that we really welcome the opportunity to appear here today. I think our particular industry is not really understood or appreciated in the area of world trade and that, in fact, commerce cannot move unless it moves across American docks and uses American labor. That is the function that the industry which I represent preforms. We are the ones, the interface between the ship and inland transporation. Neither one of those two unload or load themselves automatically.

Stevedore and marine terminal companies have substantial fixed operating costs, including terminal rentals, property taxes, equipment financing, and in this area I might say that the traditional notion which is probably prompted by "On the Waterfront" with Marlon Brando, that all a stevedore does is have a strong back and a couple of hooks he gives to the longshoreman to handle cargo is not appropriate in this day and age.

We, too, are now a capital-intensive industry. One of our member companies reported he just purchased a new container crane to be put in place in New York. It cost $4.2 million. That is private investment, pure and simple, not Port Authority money.

In addition, we have to pay for the maintenance and repair costs of that equipment. Modern technology and international trade basically requires we have data processing systems so we can track a container coming in from Rotterdam across the piers in New York, or to whatever port it will end up in the United States and the same thing going in the other direction.

In some American ports on the east coast and Gulf, there are in the collective bargaining agreements guaranteed annual wage commitments. Which means if a man works regularly for a set amount of hours and then works the next year substantially less than those hours or none at all, the employer is committed to paying him his guaranteed annual income.

Those costs remain constant despite the amount of work and must be paid, or bankruptcy declared. We have two companies that are now in chapter XI. If there is a substantial loss of revenue due to the loss of the estimated 1.9 to 2.9 million annual automobile imports, that revenue loss must come from another source.

The only other source available to NAS members is other American imports or exports. Stevedore/marine terminal operators would be obliged to raise their charges to remaining customers who in turn must raise theirs. The American consumer or exporter then ultimately will pay the increased cost. The American exporter may be priced out of a foreign market if the American transportation costs are such that he can no longer compete.

In the end, everyone ends up subsidizing the American auto industry and its workers. Mr. Chairman, that just isn't fair and makes no economic or political sense.

I would like to conclude by saying the National Association of Stevedores Union and NAS is unalterably opposed to H.R. 5133 or any other attempt to impose artificial and unwarranted barriers to the free trade of this country.

Thank you.

[The prepared statement follows:]

STATEMENT OF THOMAS D. WILCOX, EXECUTIVE DIRECTOR AND GENERAL COUNSEL, NATIONAL ASSOCIATION OF STEVEDORES

Mr. Chairman and members of the Subcommittee, my name is Thomas D. Wilcox and I am the Executive Director and General Counsel of the National Association of Stevedores. We appreciate the opportunity to appear before you this morning to express our opposition to H.R. 5133 the so-called Fair Practices in Automotive Products Act.

The National Association of Stevedores is a trade association whose 64 privately owned member companies engage in stevedoring and marine terminal operations on all four of the nation's seacoasts, the states of Alaska and Hawaii, and Commonwealth of Puerto Rico. NAS member companies contract to load and unload ships which call at this country's ports in both domestic and foreign commerce and employ longshore labor to accomplish those functions.

Mr. Chairman, recent Department of Commerce statistics show that over 95 percent by weight of this nation's foreign commerce moves by ships, ships that are loaded or unloaded by NAS member companies and the American longshoremen they employ. Enactment of H.R. 5133 or any other legislation which would impose artificial barriers to the commerce of the United States must be vigorously opposed. Such legislation is contrary to this country's commitment to free and unencumbered trade and invites retaliation from our partners in trade worldwide. Such legislation has a direct, severe and immediate adverse impact upon NAS member companies and their employees. It eliminates or reduces their employment. To attempt to create jobs for one industry and its employees at the expense of another simply doesn't make any economic sense, even though there are those who think it might make domestic political sense.

The stevedoring/marine terminal industry and its employees will be the first to feel the severe impact of the implementation of H.R. 5133. The Department of Transportation in a letter to Congressman Dingell, dated July 16, 1982, stated that fact most emplicitly, and I quote: "Unemployment in the Nation's ports would result from the loss of 1.9 to 2.9 million automobile imports. We anticipate that 7,600 to 11,600 direct jobs would be lost and 53,200 to 81,200 indirect jobs would be in jeopardy at 14 ports on the East, West, and Gulf Coasts. These ports and potential jobs losses are: Boston (900–1,300 jobs), New York (7,700–11,700), Baltimore (6,500–9,900), Hampton Roads (2,200–3,400), Jacksonville, (6,200–9,400), Tampa (900–1,300), Houston (4,200–6,400), Long Beach (6,200–9,400), Los Angeles (6,000–9,000), San Francisco (500–700), Oakland (1,000–1,600) Portland (4,900–7,500), Seattle (4,500–7,000), and Savannah (500–700)."

The proponents of H.R. 5133 have given no explanation or justification as to why some 11,600 longshoremen should be put out of work, or why the 81,000 port related employees should be placed on the unemployment rolls. In truth, there is none to give.

I'm sure that others will testify about the financial impact of H.R. 5133 on domestic auto prices and other related products but there is another inevitable cost impact which has to be considered. Stevedore and marine terminal companies have substantial fixed operating costs, including terminal rentals, property taxes, equipment financing, maintenance and repair costs, and in some ports guaranteed annual wage payment commitments under collective bargaining agreements. Those costs remain constant despite the amount of work and must be paid, or bankruptcy declared. It there is a substantial loss of revenue due to the loss of the estimated 1.9 to 2.9 million annual automobile imports, that revenue loss must come from another source. The only source available to NAS members is other American imports or exports. Stevedore/marine terminal operators would be obliged to raise their charges to other customers who in turn must raise theirs. The American consumer or exporter then ultimately will pay the increased cost. In the end, everyone ends up subsidizing the American auto industry and its workers. Mr. Chairman, that just isn't fair and makes no economic or political sense.

Finally, Mr. Chairman let me again say that the NAS is unalterably opposed to H.R. 5133 or any other attempt to impose artificial and unwarranted barriers to the free trade of this country.

Thank you.

LIST OF NAS MEMBER COMPANIES

Almont Shipping Co.,
Wilmington, N.C.
Atlantic Container Line, Ltd.,
New York, N.Y.
Baton Rouge Marine Construction, Inc.,
Port Allen, La.
Border Stevedoring,
Brownsville, Tex.
Brady-Hamilton Stevedore Co.,
Portland, Oreg.
Richard Bugg & Co., Inc.,
Corpus Christi, Tex.
Capital City Stevedores,
Port Allen, La.
Carolina Shipping Co.,
Charleston, S.C.
Ceres Terminals, Inc.,
Chicago, Ill.
Christina Service Co.,
Wilmington, Del.
Cilco Terminal Co., Inc.,
Bridgeport, Conn.
John T. Clark & Co.,
Boston, Mass.
Codan Corp.,
Erie, Pa.
Cooper Stevedoring Co., Inc.,
Mobile, Ala.
Bernard S. Costello, Inc.,
Boston, Mass.
Dalton Steamship Co.,
Houston, Tex.
Detroit Marine Terminals, Inc.,
Detroit, Mich.
Dix Shipping Co.,
Brownsville, Tex.
Dixie Stevedores, Inc.,
Houston, Tex.
Eagle Marine Services, Ltd.,
Oakland, Calif.
Eller & Co., Inc.,
Fort Lauderdale, Fla.
Global Terminal & Container Services,
Jersey City, N.J.
Gulf Stevedore Corp.,
Houston, Tex.

Harrington & Co., Inc.,
Miami, Fla.
Howland Hook Marine Terminal Corp.,
New York, N.Y.
Independent Pier Co.,
Philadelphia, Pa.
International Great Lakes Shipping Co.,
Chicago, Ill.
International Terminal Operating Co., Inc.,
New York, N.Y.
Interocean Stevedoring Inc.,
New Orleans, La.
Lavino Shipping Co.,
Philadelphia, Pa.
Maersk Container Service Co., Inc.,
Port Newark, N.J.
Maher Terminals, Inc.,
Jersey City, N.J.
Manchester Terminal Co.,
Houston, Tex.
Marine Terminals Corp., (of L.A.),
Long Beach, Calif.
McCabe, Hamilton & Renny Co., Ltd.,
Honolulu, Hawaii
John W. McGrath Corp.,
New York, N.Y.
Meehan Seaway Service, Ltd.,
Milwaukee, Wis.
Metropolitan Stevedoring Co.,
Wilmington, Calif.,
Multi-Terminal Operators, Inc.,
Old San Juan, P.R.
New Bedford Stevedoring Corp.,
New Bedford, Mass.
New Haven Terminal, Inc.,
New Haven, Conn.
Old Dominion Stevedoring Corp.,
Norfolk, Va.
John Orr & Son, Inc.,
Providence, R.I.
Palmetto Shipping & Stevedoring,
Charletson, S.C.
Pate Stevedore Co.,
Mobile, Ala.
Pate Stevedoring Co.,
Tampa, Fla.
Pinney Dock & Transport Co.,
Ashtabula, Ohio
Pittston Stevedoring Corp.,
New York, N.Y.
Port Houston Terminal, Inc.,
Houston, Tex.
Port Stevedoring Company, Inc.,
Houston, Tex.
Rogers Terminal & Shipping Corp.,
New Orleans, La.
Ryan-Walsh Stevedoring Co., Inc.,
Mobile, Ala.
Sealand Terminal Corp.,
Bayonne, N.J.
Seattle Stevedore Co.,
Seattle, Wash.
Shippers Stevedoring Co.,
Galena Park, Tex.
Southern Stevedoring Co., Inc.,
Houston, Tex.
Southern Stevedoring Co., Inc.,
New Orleans, La.
Southside Service Co., Inc.,
Houston, Tex.
Strachan Shipping Co.,
Savannah, Ga.
T. Smith & Son, Inc.,
New Orleans, La.
Terminal Services Houston, Inc.,
Galena Park, Tex.
Universal Maritime Service Corp.,
New York, N.Y.
Wilmington Shipping Co.,
Wilmington, N.C.
Young & Company of Houston,
Houston, Tex.

Chairman GIBBONS. Mr. Wilcox, I appreciate your very strong statement. I frankly had not realized on page 2 of your statement the job loss was that great in your industry. I appreciate you bringing that out.

I notice some of the congressmen from the Baltimore area have cosponsored this legislation. I also note the Department of Transportation estimates the job loss will be that large in Baltimore alone.

Mr. WILCOX. I cannot attest to the accuracy of the Department of Transportation figures, because the actual calculation of job loss depends upon the type of the ship and the gang sizes involved; but if you lose an automobile ship and you have 36 men who would normally be working that ship, those 36 people are out of work; just for one ship.

Chairman GIBBONS. Do you think these job loss estimates by the Department of Transportation are accurate or near accurate?

Mr. WILCOX. I think they are a little on the high side, but I think we could find out, just get a better estimate. I don't know what methodology they used. If you use the—I tried to run calculations out myself, and if you use the standard time the ship is in port, not just the actual time it is loading, or the fact that you may have 6 people working unloading the ship but you are paying 36 men to do it, then you would have numbers that high; yes.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman. Thank you for your testimony, Mr. Wilcox.

One of our witnesses I believe told us there would be a loss of 14,000 jobs in your industry, and I cannot find that testimony, so I will have to look it up, maybe get a chance to discuss it with you a little later; but whether it is 10 or 14 or 7 or more or less, I assume it is more jobs than your industry can afford to give up at the moment?

Mr. WILCOX. It is more than they can afford to give up primarily because we are still going to have to pay extraordinarily high benefits to those persons who are not working.

Mr. FRENZEL. How do your employees feel about being offered up for another industry?

Mr. WILCOX. Mr. Frenzel, this is probably one of the few issues that I have dealt with in the 8 years I have been with the National Association of Stevedores in which my association, the International Longshoremen's Association, and the American Association of Port Authorities all agree. They are opposed to it.

Mr. Gleason wrote a letter, I believe, to the Secretary of Commerce and perhaps to this committee that he couldn't understand it, either.

Mr. FRENZEL. We did receive testimony from Mr. Gleason yesterday indicating the opposition of his union to this bill. I suggest that your corroborating evidence is simply piled on top of his.

I thank you very much for your testimony.

Chairman GIBBONS. Mr. Bailey?

Mr. BAILEY. Thank you very much, Mr. Chairman.

Mr. Wilcox, what percentage of the loading and unloading that you do is automobiles?

Mr. WILCOX. I don't have those figures available, sir.

Mr. BAILEY. Could you get that? In other words, if you can relate it to the employment figures, you know, of the things that you bring in, the things that you load and unload. Of course, a lot of the work is export.

Mr. WILCOX. That would be like comparing apples and oranges. If you compare automobile units to tons of grain, the automobile units are going to go down, because you use a lot less labor in the grain operation.

Mr. BAILEY. That is what I mean. If there is some way that you could find out just how much of that time or labor or effort, if it is possible to measure, is put into simply the unloading of the automobile import.

Mr. WILCOX. We will give it a try. It is an almost impossible task. We will give it a shot. We only represent about 75 percent of the industry. There will be another 25 percent out there that will be unaccounted for.

Mr. BAILEY. You can extrapolate if they are not awfully involved in auto imports. You can make some sort of comparison, if possible.

If you look at the impact of this bill on employment, indigenous unemployment in the United States, what impact it would have on imported items at all?

Mr. WILCOX. You mean how much in cost is going to be passed on?

Mr. BAILEY. No. Perhaps in terms of importing other items, would you get busier? Your statement and the way in which it was presented indicates to me that you obviously feel very, very strongly about this issue. I respect that.

Mr. WILCOX. And many others, yes.

Mr. BAILEY. I know that you do. I can tell emotionally it is awfully important to you. Don't misinterpret this question. I am not trying to dig at you.

You mentioned retaliation. You said you had experience with that. The problem I have with retaliation is when you look at what we do in terms of our trade environment here and our import barriers, et cetera, whether they have been official or otherwise, I have a hard time seeing how anybody is going to retaliate. What did we do to earn the difficulties of marketing in Japan?

Mr. WILCOX. Mr. Bailey, to protect the domestic steel industry when this Government-instituted trigger price mechanism, to my knowledge they put four employers out of business in the Great Lakes, including two in Detroit, in Mr. Vander Jagt's State, who primarily depended upon handling of imported steel products which were then consumed by the automobile industry and others.

The trigger price mechanism came in. These people were out of business. Now they can't come back. They are gone and their employees are unemployed.

Mr. BAILEY. Why do you think that trigger price mechanism was used? Do you think it was justified? It is very clear steel was being dumped. Do you want Government support of your industry or subsidization of your industry?

Mr. WILCOX. Absolutely not.

Mr. BAILEY. You feel very strongly about that ?

Mr. WILCOX. Absolutely.

Mr. BAILEY. The only reason those mechanisms were written into law and set up in the first place was because that was a matter of the issue. The issue was subsidization, selling below cost.

Mr. WILCOX. Our point, Mr. Bailey, is if you subsidize one part of the American industry without studying the economy, 9 times out of 10 another part suffers. We don't want to suffer the same way with the automobile industry the way we suffered because of the steel industry.

Mr. BAILEY. When you say because of the steel industry, I think you should look at some of the deeper causes. I don't expect you to necessarily agree with them. If you say to me you don't want the Government interfering with you, then you are saying this market is supposed to absorb dumped products from abroad, why in terms of retaliation, if we go one step further, do we have to suffer it abroad and do nothing about it at home?

I guess the end line of that reasoning, it is a very clear deduction from step to step, that I am raising is how should we respond? I sympathize with you. I mean that. I can see how strongly you feel about this. I feel with you. I do.

The problem is, what do you think we should do to respond? You don't want Government interference with your business. But you are asking steel workers and auto workers—I will let you answer—why are they supposed to suffer at the hands of coveted industries from abroad, too?

No one cares and raises that question. I hear very little in this committee at all—nobody complains about what they are doing over there. So if you have an industry that is either targeted or suffers inadvertently or excessively here, they are supposed to suffer in silence and die and that's all that is supposed to be done.

Now, to say they are not even supposed to raise a countervailing duty, or dumping complaint, or perhaps to try to utilize to their advantage a trigger price mechanism based upon that reality, you are asking them on the other hand to die so that you are not affected.

So we are all in the boat together. What do we do? I know you don't want this. What do you suggest we do about the problem?

Mr. WILCOX. I listened to Mr. Smith's testimony today. I am able to read the papers. I think the auto industry and auto unions are beginning to work out their problems. I think this type of legislation would stop that process because you are going to guarantee jobs.

Second, I think as to the automobile industry and the American consumer, of which I am one, are tired of buying a new car every year and a half. So your car sales are going down. My own experience, and I own an American car, is that the quality of that car is so good I will try to drive it 150,000 miles instead of turning it in every 20,000 miles.

So there is a major change, I think, in the American consumer and his attitude as to the products he buys. Passing legislation like this will deny him the opportunity to do that.

Mr. BAILEY. Let me finish with this. I understand how you feel and how strongly you feel it. I think what you are saying is it's a piece of legislation in response to a lot of other wrongs and it is unfortunate these difficulties have fallen on their heads for many years. No one was that concerned with doing anything about it.

But the idea of retaliation and unwarranted barriers—and I am quoting you—artificial and unwarranted barriers, that is a little hard for me to go along with. So I understand your feelings. I accept your complaint about your being impacted. I can understand that the business in which you are engaged, it is going to impact you directly.

I am not so sure that the overall effect over time will not be beneficial; however, but I have no way of projecting that. I don't know. But I just cannot go with that unwarranted adjective there. That is my problem, I guess.

I am asking you if we do not do this, what do you suggest we do? I am not saying you are even prepared to answer that. I don't want to be unfair to you. I don't know if you are.

Mr. WILCOX. What I would like this committee to do is when it makes or investigates specific complaints of specific industries in the area of international trade that it consider the interest of all players involved and not just the one who yells the loudest.

There are many people involved in moving that automobile from Japan and/or the American car from here to wherever it goes, more than just the people in the United States of America who make it. Those people have a right to be considered.

Mr. Bailey. Look, I will finish up with this. Mr. Brodhead is waiting.

Let me say this to you: There is a lot more involved; this thing has been characterized as the UAW and the automobile industry. That is nonsense. We are talking about a train of products and peripheral employment, et cetera, that goes far, far, far beyond them; and those of us who have supported this legislation are also talking about some principles and some inability of our Government to negotiate in the trade area that has been going on for countless years and the public is just getting fed up with it.

You may be a hapless victim of that. There may be some who disagree with whether or not you are. I don't. I don't question at all your feelings; certainly the immediate impact; but there are a lot of people who can make very cogent arguments, the overall benefits on getting other countries around this world to wise up—to talk about retaliation against us is farcical in terms of the way we have been treated for years.

There are many people who are going to say the benefits to a really true free trade via the—and I go back to your statement—the domestic political benefits of this legislation exceed not doing anything at all and letting these industries die. They are going to die, some of them.

I just respectfully disagree with you on the effects of legislation.

Mr. Wilcox. I don't believe those 11,000 unemployed longshoremen would, though.

Mr. Bailey. I don't know about whether you are correct or I am correct on the argument. I just do not know. I know when somebody comes up to me with a Carribean Basin Initiative and blandly says, we can do away with 250,000 or 350,000 American jobs in that regard——

Chairman Gibbons. You know, that—I am not going to characterize that. I am not going to characterize that.

Mr. Bailey. Those are the figures we were given, Mr. Chairman.

Chairman Gibbons. I don't know who gave you those figures. Nobody who has any sense gave you those figures. I can tell you that. I attended every hearing. I never heard those figures anywhere. I don't know where you dreamed those up.

Go ahead. I am sorry I interrupted you. I apologize.

Mr. Bailey. I am sorry you did, too. I don't get angry very often. One thing I did do is my homework. I challenge the chairman on his attention to the information that has been brought before the committee, because it is very clearly in testimony.

In fact, I was conservative on the estimated job loss. They may not be of a source that the chairman finds credible, and I am not so sure how accurate they are, but I am sure they are somewhere in the ballpark. Incidentally, and I would be willing to stand to be corrected on this—even the testimony from the administration was in the neighborhood of 50 to 100,000 jobs. That is correct.

That is the point I am trying to make with the gentleman here, if I may reclaim the time.

That was simply that you are talking about a direct employment loss of 11,000. You are talking about unemployment. Mr. Brodhead has expertise in this area. You are talking about unemployment in the steel industry which is much, much higher.

Incidentally, much of it is also structural in nature. That is my last question: Do you think this would be permanent based upon your projections of retaliation, et cetera? So you think we are talking about structural unemployment with this 11,000-something that will continue—will be for good, will never, never come back and won't be replaced by rising consumption, et cetera, with some of the work they may be handling other items and that kind of thing?

Mr. WILCOX. Our industry, unlike others, employs labor on an as-needed basis. We have no full-time, daily-hourly labor on the company payroll. You may have 40 people who work in the terminal, but the longshoremen who unload the ship are hired from a hiring hall as needed. If they don't have employment for 2 weeks, they are going to go somewhere else, if possible, or they will be on unemployment compensation.

We can go back to the hiring hall after these people have been out of business for 6 months, they may not come back. You don't know.

Mr. BAILEY. Do you know what unemployment is in the automobile industry?

Mr. WILCOX. I have not read the latest figures, no.

Mr. BAILEY. Mr. Don Pease on this committee, in his district alone, is facing unemployment of 50,000; just his district, one congressional district.

Again, I don't want to debate it with you. I think the point you are making is good. You are raising a legitimate complaint, but it is not fair to talk around it. I think there is some honest feeling about the impact overall of the legislation, its effect on American policymakers, and particularly its effect on decisionmakers abroad who have to understand that sooner or later things are going to get out of hand if something is not done to give the average American a sense of fairness in trade.

The country does feel victimized to a degree. I think the endless chain of testimony we have had always points at the same things. People can do business here, but we can't do business abroad. Somehow we are supposed to take that, smile, and walk away. That is not fair.

I thank you very much.

Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Brodhead?

Mr. BRODHEAD. Thank you, Mr. Chairman.

Mr. Wilcox, in response to the chairman's question you indicated that you thought it was at least conceivable that the DOT figures on unemployment in your industry, should this bill be enacted, may be high. I would certainly—it would certainly seem that way to me; there is no question that should this legislation go into effect and be successful that it will result in a lowering of the volume of business that your employers do and a lowering of fewer job opportunities in that industry.

I certainly can understand your concern in that regard. I am a proponent of this legislation because I believe it is in the interest of the whole country, but very clearly it is going to have an adverse effect on your industry. I understand the concern you have. I wish I had an answer. I don't have an answer. I really don't want to argue with you because you have a very important and a very legitimate concern.

I thank you for being here and bringing it to the attention of this committee.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Vander Jagt?

Mr. **Vander Jagt**. I would just like to thank the witness, Mr. Chairman. No questions.

Chairman **Gibbons**. Thank you very much, sir.

The committee is going to recess now until 2 o'clock. I am sorry we have taken so much time. We are going to have a series of rollcall votes. We will reconvene at 2 o'clock.

[Whereupon, at 11:53 a.m., the hearing was recessed, to reconvene at 2 p.m.]

AFTERNOON SESSION

Chairman **Gibbons**. Good afternoon, ladies and gentlemen. We will resume our domestic content hearings. Our first witnesses this afternoon are from the Automobile Importers of America: George Nield, Ralph Millet, and John Rehm.

STATEMENT OF GEORGE C. NIELD, PRESIDENT, AUTOMOBILE IMPORTERS OF AMERICA, INC., ACCOMPANIED BY RALPH T. MILLET, CHAIRMAN, AND JOHN B. REHM, COUNSEL

Mr. **Nield**. Mr. Chairman, members of the subcommittee, I am George C. Nield, president of the Automobile Importers of America. I will refer to that as AIA. AIA is the association of motor vehicle importers in the United States. A list of the members of AIA is attached to your statement.

Accompanying me here is Ralph T. Millet, who is chairman of the board of AIA. He is also a director of the Saab Automobile Company of Sweden.

Also accompanying me is Mr. John B. Rehm, our special counsel, with the firm of Busby, Rehm and Leonard.

AIA is strongly opposed to the local content bill that has been reported by the House Energy and Commerce Committee and referred to this subcommittee. The bill is touted as a jobs bill and as a fair practices bill. In fact, it is neither, since it would: (1) fail to induce foreign automobile manufacturers to produce in this country; (2) cause a net loss of jobs throughout the national economy; (3) increase the retail price of automobiles, and thus hurt the consumer; (4) impair the efforts of Detroit to become more competitive; and, perhaps most importantly, (5) repudiate the principle of fair competition in international trade for all products.

In view of the time constraints of this committee, I would be pleased to summarize the balance of my statement but I would ask that the complete statement be included in the record.

Chairman **Gibbons**. Yes, sir. The complete statement will certainly be included in the record.

Mr. **Nield**. First, let me say the automobiles being imported from Europe and Japan are fairly traded. Indeed, no formal complaint of an unfair trade practice involving imported automobiles has even been filed in the last 7 years. Not only are imported automobiles fairly traded, but they have been found not to be the major cause of the serious economic injury that the domestic automobile industry has suffered over the last 5 years.

I should add that in absolute terms, automobile imports have actually fallen. It is true imports have increased their relative share of the U.S. market, but that is due to the continuing fall in consumption, for which imports are just not responsible.

The fact that the local content bill targets imports reveals not only its illogic but, as I will explain in a few minutes, its implicit attack on the very principle of fair competition in international trade.

Let me first, however, take up and refute the five basic claims that the UAW make in support of the bill. The United Auto Workers claim the local content bill will induce foreign automobile manufacturers to produce in this country and thereby increase employment in the industry.

The bill will fail to do so. Foreign automobile manufacturers have already made a $2 billion start in plant investment in this country, and further investment is contemplated.

Enactment of the bill, however, would destroy the prevailing climate and would, for the first time in our history, represent a permanent interference by the U.S. Government in the making and selling of automobiles. Such a specter would almost certainly dissuade foreign automobile investors from making investments in this country.

Indeed, by so drastically changing the present economic climate, the bill would also discourage the continued operation of the plants already etablished by the foreign manufacturers in this country.

Second, the UAW claims the local content bill will save or create more than 700,000 jobs in both the automobile and related industries. This claim is invalid since it wrongly assumes that the bill will attract new plant investment by foreign manufacturers and will not provoke retaliation or emulation by other countries.

What will happen to employment if there is no significant plant investment by the major foreign manufacturers? A study of the current bill made by the Congressional Budget Office shows that under such conditions, the domestic automobile and related industries would gain about 170,000 jobs.

On the other hand, the imported car and related industries, which account for about 160,000 jobs, would certainly lose a substantial number of those jobs. Moreover, there is a distinct likelihood that any net gain in the automotive sector would be more than wiped out by the loss of jobs in the U.S. export industries.

As the Congressional Budget Office noted in its analysis of the current bills, the national economy might well suffer an overall net loss of about 66,000 jobs as a result of this bill.

Third, the UAW claims that the local content bill will not cause any increase in the retail price of automobiles. This claim must also fall if enactment of the bill will not induce major plant investments by foreign automobile manufacturers. If the quota provisions of the bill should operate, the Congressional Budget Office estimates that imports would fall by about 1.1 million units.

In 1980, the staff of the Federal Trade Commission estimated a price increase of as much as $838, assuming only a 700,000 drop in the number of imports. This would, in turn, further discourage the purchase of new automobiles by consumers who are already reeling from sticker shock.

Fourth, the United Auto Workers claims that the local content bill would maintain the competitiveness of the domestic industry. The local content bill would go far to defeat the world car strategy upon which Detroit is properly basing its hopes for future profitability.

This strategy necessarily assumes that a U.S. automobile manufacturer will be able to obtain parts from the most readily available and economical sources throughout the world.

By this strategy, General Motors, Ford, Chrysler, and Volkswagen were able to introduce new and fuel-efficient models on a timely basis to meet consumer demand.

Fifth, the UAW claims that the foreign automobile manufacturers have some kind of a moral obligation to produce automobiles in this country. Consider the consequences of requiring our strongest export industries like aircraft and wheat to produce in those countries in which they market.

The very economic advantages that render such export industries so efficient would be visciated to the detriment of both the exporting and importing countries.

For all of the serious objections that I have raised about the local content bill, they are distinctly secondary to its fundamental deficiency. This bill is, in its basic terms, an outright repudiation of the principle of fair competition in international trade for all products.

Consider for a moment the destructive consequences of such an idea. In all but 2 years, since the end of World War II, our trade in both goods and services has been in surplus. In 1980 and 1981, that surplus was at its second highest level since World War II, between $23 and $24 billion.

In other words, through fair competition we have sold more goods and services than we have bought. Our ability to do so would vanish if other countries adopted the pernicious philosophy of the local content bill. The fact that the local content bill would so baldly violate the GATT simply confirms its fundamental invalidity.

It would send a signal to our trading partners that the United States no longer believes in the rules of fair international competition, and this would be particularly ominous at a time when the world economy is in such distress and the protectionist pressures besetting other countries are so strong.

In summary, then, the local content bill is not just about imported automobiles. It concerns the very foundation of the international trading system that has served the United States and other countries so well for about 35 years.

AIA therefore urges you to call this bill what it really is—a pernicious effort to repudiate the principle of fair competition in international trade.

Thank you, Mr. Chairman. That concludes my prepared statement. We will be happy to answer any questions you may have.

[The prepared statement follows:]

STATEMENT OF GEORGE C. NIELD, PRESIDENT, AUTOMOBILE IMPORTERS OF AMERICA, INC.

SUMMARY

1. The local-content bill attacks a product that is fairly traded. Foreign automobiles are sold in this country in fair competition with domestic automobiles and have been found not to be the major cause of Detroit's difficulties.

2. The bill will not induce foreign automobile manufacturers to produce in this country and thereby increase employment in the industry. It will radically alter the economic climate in which to trade with, and invest in, the United States, and it will create the spectre of permanent governmental interference with the market place. This will seriously discourage new plant investment by foreign companies.

3. The bill will bring about a net loss of jobs throughout the national economy. Any gain of jobs in the automotive sector will be more than offset by the loss of jobs in export industries that will suffer from retaliation or emulation by other countries. The net loss has been estimated to be about 66,000 jobs.

4. The bill will increase the retail price of automobiles. By reducing imports as much as about one million units, it will cause an estimated price increase of about $300 to $800 per car.

5. The bill will render the domestic automobile companies less competitive. It will undermine their "world-car" strategy, which assumes that they will be able to obtain parts from the most readily available and economical sources throughout the world.

6. The bill seeks to destroy the principle of comparative advantage. It attempts to force foreign companies to produce automobiles in this country regardless of the comparative efficiencies of producing abroad. Such a policy could seriously injure our own major export industries.

7. The bill is, in its basic terms, an outright repudiation of the principle of fair competition in international trade. It would violate the GATT and send a signal to our trading partners that the United States has abandoned its liberal trade policy—and all of the benefits of that policy.

STATEMENT

Mr. Chairman and members of the Subcommittee, I am George C. Nield, President of the Automobile Importers of America, Inc. (AIA). AIA is the association of major automobile importers in the United States, and a list of its members is attached. Accompanying me are Ralph T. Millet, Chairman of AIA, and our special counsel, John B. Rehm, of the firm of Busby, Rehm and Leonard.

AIA strongly opposes the local-content bill that has been reported by the House Energy and Commerce Committee and referred to this Subcommittee. This bill is touted as a "jobs bill" and as a "fair practices" bill. In fact, it is neither, since it would: (1) fail to induce foreign automobile manufacturers to produce in this country; (2) cause a net loss of jobs throughout the national economy; (3) increase the retail price of automobiles, and thus hurt the consumer; (4) impair the efforts of Detroit to become more competitive; and—perhaps most importantly—(5) repudiate the principle of fair competition in international trade for all products.

At the outset, it is important to understand the nature of the trade that the local-content bill is attacking. The automobiles being imported from Europe and Japan are fairly traded. That is, they are sold in this country in fair competition with domestic automobiles. They are not brought into this country by such unfair commercial practices as dumping, subsidization, infringement of U.S. patents, or other practices proscribed by our trade laws. The allegations of unfair trade practices that have been directed against imported automobiles have not been substantiated. Indeed, no formal complaint of an unfair trade practice involving imported automobiles has even been filed in the last seven years.

Not only are imported automobiles fairly traded but they have been found not to be the major cause of the serious economic injury that the domestic automobile industry has suffered over the last five years. In 1980, the U.S. International Trade Commission decided that the major cause of such injury was the severe decline in consumption of all automobiles. Unfortunately, that decline has continued into 1982 and remains the basic reason for the plight of the domestic industry.

I should add that, in absolute terms, automobile imports have actually fallen. In 1981, they were less than in either 1979 or 1980. Moreover, their level in the first eight months of 1982 is well under that in the same period of 1980 and 1981. It is true that imports have increased their relative share of the U.S. market. But that is due to the continuing fall in consumption, for which imports are not responsible.

In short, the local-content bill is directed against a product that is fairly traded and that has been found not to be the major cause of Detroit's difficulties. In such a case, it would be logical and rational to pursue other ways of assisting the domestic industry. The fact that the local-content bill targets imports reveals not only its illogic but, as I will explain in a few minutes, its implicit attack upon the very principle of fair competition in international trade.

Let me first, however, take up and refute the five basic claims that the UAW makes in support of the bill. First, the UAW claims that the local-content bill will induce foreign automobile manufacturers to produce in this country and thereby increase employment in the industry. The bill will fail to do so, however, because it represents such a radical and ominous change in the economic climate of the United States. At present, the United States is a relatively open country with which to trade and in which to make plant investments. Both its laws and policies give domestic and foreign firms the necessary confidence that this relatively open climate will endure. For this reason, foreign automobile manufactuers have already made a $2 billion start in plant investment in this country, and further investment is contemplated.

Enactment of the bill would destroy the prevailing climate and would, for the first time in our history, represent a permanent interference by the U.S. Government in the making and selling of automobiles. As a result, all manufacturers would be subject not only to the reality of artificial restraints upon their operations but to the threat of further governmental control. Such a spectre would almost certainly dissuade foreign automobile manufacturers from making new plant investments in this country.

Indeed, by so drastically changing the present economic climate, the bill would also discourage the continued operation of the plants already established by the foreign manufacturers in this country. Nissan is building a $660 million facility in Smyrna, Tennessee, that is designed to assemble light-duty trucks. The President of that facility is on record about the severe problems that the local-content bill would create for Nissan. He has pointed out that the bill would seriously jeopardize Nissan's investment in the United States. I am sure that he will cover this in detail in his testimony tomorrow.

Second, the UAW claims that the local-content bill will save or create more than 700,000 jobs in both the automobile and related industries. This claim is invalid since it wrongly assumes that the bill will attract new plant investment by foreign manufacturers and will not provoke retaliation or emulation by other countries. I have already given the reasons why the bill will discourage both the making of new, and even the continuation of existing, plant investment by foreign manufacturers.

What then will happen to employment if there is no new significant plant investment by the major foreign manufacturers? A study of the current bill made by the Congressional Budget Office shows that, under such conditions, the domestic automobile and related industries would gain about 107,000 jobs. On the other hand, the imported car and related industries, which account for about 160,000 jobs, would certainly lose a substantial number of those jobs. Moreover, there is a distinct likelihood that any net gain in the automotive sector would be more than wiped out by the loss of jobs in U.S. export industries. Enactment of the local-content bill could well provoke either retaliation or emulation by other countries that would reduce the volume of U.S. exports to such countries. The Department of Commerce has estimated that $15 billion in exports of high technology and farm products would be vulnerable to such actions. As the Congressional Budget Office noted in its analysis of the current bill, the national economy might well suffer an overall net loss of about 66,000 jobs as a result of this bill. This would seem to be conservative based upon the estimates of other analysts. Clearly this cannot be what supporters of this legislation have in mind when they refer to this as a "jobs bill".

Third, the UAW claims that the local-content bill will not cause any increase in the retail price of automobiles. Like the claim of more jobs, this claim must also fall if enactment of the bill will not induce major plant investments by foreign automobile manufacturers. If the quota provisions of the bill should operate, the Congressional Budget Office estimates that imports would fall by about 1.1 million units. We have already seen the retail price increase caused by Japan's relative modest export restraints. A drop of 1.1 million in imports would not only reduce the selection of automobiles available to the consumer, but, in addition, it would almost certainly bring about a substantial retail price increase. The Congressional Budget Office has estimated an increase of about $330 per automobile, but this seems conservative. In 1980, the staff of the Federal Trade Commission estimated a price increase of as much as $838, assuming only a 700,000 drop in imports. Such a price increase would, in turn, further discourage the purchase of new automobiles by consumers already reeling from "sticker shock".

Fourth, the UAW claims that the local-content bill would maintain the competitiveness of the domestic industry. Since this claim also rests upon the basic—and invalid—premise of large new plant investments in this country, it necessarily collapses together with the second and third claims. More importantly, however, the local-content bill would go far to defeat the "world-car" strategy upon which Detroit is properly basing its hopes for future profitability. This strategy necessarily assumes that a U.S. automobile manufacturer will be able to obtain parts from the most readily available and economical sources throughout the world. By this strategy, General Motors, Ford, Chrysler, and Volkswagen were able to introduce new and fuel-efficient models on a timely basis to meet consumer demands. In order to satisfy the local-content requirement of the bill, however, a manufacturer will have to buy almost exclusively U.S. parts. By doing so, it will have rendered its automobile less competitive in U.S. and world markets.

Fifth, the UAW claims that the foreign automobile manufacturers have some kind of a moral obligation to produce automobiles in this country. The theory seems to be that, if you participate significantly in a foreign market by exporting to that market, you should also manufacture in that market. Such a theory is economic nonsense, since it would destroy the principle of comparative advantage. Consider the consequences of requiring our strongest export industries, like aircraft and wheat, to produce in those countries in which they market. The very economic advantages that render such export industries so efficient would be vitiated, to the detriment of both the exporting and importing countries.

For all of the serious objections that I have raised about the local-content bill, they are distinctly secondary to its fundamental deficiency. This bill is, in its basic terms, an outright repudiation of the principle of fair competition in international trade for all products.

Consider, for a moment, the destructive consequences of such an idea. In all but two years—1977 and 1978—since the end of World War II, our trade in both goods and services has been in surplus. In 1980 and 1981, that surplus was at the second highest level since World War II—between $23 and $24 billion. In other words, through fair competition, we have sold more goods and services than we have bought. Our ability to do so would vanish if other countries adopted the pernicious philosophy of the local-content bill. The principle of fair competition in international trade would be abandoned, and countries would resort to expedient devices for short-term commercial benefits.

The fact that the local-content bill would so badly violate the GATT—and particularly Articles III and XI—simply confirms its fundamental invalidity. The GATT is based upon the principle of fair competition in international trade. It clearly recognizes that that principle is subverted by local-content requirements and by quantitative restrictions used to enforce such requirements. The GATT therefore flatly outlaws such devices. For the United States to enact the local-content bill would go far to destroying the effectiveness of the GATT—and only two years after the successful efforts of the Tokyo Round to strengthen the GATT. It would send a signal to our trading partners that the United States no longer believes in the rules of fair international competition. This would be particularly omninous at a time when the world economy is in such distress and the protectionist pressures besetting other countries are so strong.

In summary, then, the local-content bill is not just about imported automobiles. It concerns the very foundation of the international trading system that has served the United States and other countries so well for about 35 years. Are we really prepared to jettison the system with this local-content bill? Are we really prepared to do so when the bill would probably work to the net disadvantage of the U.S. automobile industry itself? AIA cannot believe that this Subcommittee and the full Ways and Means Committee—with its long tradition of responsible support for liberal trade—would approve this bill. AIA therefore urges you to call the bill what it really is—a pernicious effort to repudiate the principle of fair competition in international trade.

Thank you, Mr. Chairman. That concludes my prepared statement. We will be happy to answer any of your questions.

Members of Automobile Importers of America, Inc.: Alfa Romeo; BMW; DeLorean; Fiat; Honda; Isuzu: Jaguar Rover Triumph; Lotus; Mazda; Mitsubishi; Nissan; Peugeot; Rolls-Royce; Saab-Scania; Subaru; Toyota; and Volvo.

Chairman GIBBONS. You are very mild. I have called it a lot worse than that right here.

Mr. Bailey?

Mr. BAILEY. Thank you, Mr. Chairman. I am usually gentle in public and private, by the way. I respectfuly disagree with you.

I do have a couple of questions. By the way, I think you state the position on behalf of your people very well. I want to compliment you. However, there are a few little conclusions you reached that I just might like to question.

Are you involved in the importing of automobiles into Japan?

Mr. NIELD. No, sir.

Mr. BAILEY. Oh.

Mr. NIELD. We do represent 17 automobile manufacturers from Europe and from Japan that import into the United States.

Mr. BAILEY. That sell here? You are not a world trade organization, then?

Mr. NIELD. Only a one way trade.

Mr. BAILEY. Only one way trade. Oh, I see.

At the top of page 2 of your statement, it says "That is, they are sold in this country in fair competition with domestic automobiles."

I agree with you. I think you are right. I want the record to show that. I am curious, though, if in your travels or experiences whether or not you know that our automobiles are sold in fair competition with other automobiles in Japan; do you know? Or Europe? I don't know.

Mr. NIELD. Yes, sir, I believe they are.

Mr. BAILEY. You believe they are?

Mr. NIELD. Yes, sir.

Mr. BAILEY. You are a very lonely man. You might be right, but I think you would be pretty lonely with that statement.

Are you familiar with any concept called downstream dumping? Does that mean anything to you?

Mr. NIELD. It probably would mean something to John Rehm, our legal counsel.

Mr. REHM. I am sorry, Mr. Bailey. I have not heard the term. I have heard of downstream subsidies, but not downstream dumping.

Mr. BAILEY. How do you define downstream subsidization?

Mr. REHM. Where the allegedly subsidized——

Mr. BAILEY. Allegedly? I know you are a lawyer. I love it.

Mr. REHM. Since we represent foreign manufacturers, I feel constrained to use that term.

Mr. BAILEY. I am following you.

Mr. REHM. Let's call them the subsidized manufacturers to make it simpler.

Where he is receiving products that he needs to make his product for exportation, and those products benefit from some kind of government subsidy. In other words, not only is he himself receiving subsidies, allegedly, from the foreign government, but products, inputs into his product, are also similarly so benefitted.

Mr. BAILEY. That is sort of like a situation where it would be illegal or improper, at least subject you to some type of countervailing or antiduty action were you to sell a directly subsidized, supposedly directly subsidized product in an American market, and that would be consistent with GATT, would it not?

Mr. **REHM**. Yes. The whole problem of upstream subsidies is a difficult one. As you may know, the Department of Commerce is grappling with that in the steel cases, to a degree. I want to repeat: there are limitations to the concept.

Nevertheless, to a degree, you are correct. Some so-called upstream subsidies would be subject to countervailing duties consistent with the Subsidies Code we negotiated in the Tokyo Round.

Mr. **BAILEY**. But it is very hard to get the data, hard to prove?

Mr. **REHM**. Often.

Mr. **BAILEY**. Often is. Although if you look at all the cases filed there have been quite a few settled because apparently they are successfully argued, at least as I understand it. We had the commerce people in, were asking them about some of the cases that were filed. They seemed to say there were quite a few that are successfully pursued.

Mr. **REHM**. To my knowledge, at least, that is true of the steel cases. I think, frankly, before the steel cases, you did not see extensive exploration of upstream subsidies.

Mr. **BAILEY**. Let me ask you a common sense question: If I were going to sell a ton of steel in the United States of America at below cost, would I have a propensity—this is the wildest form of speculation—to sell that ton of steel below cost to a Japanese automobile manufacturer; do you know?

Mr. **REHM**. I really have no basis for responding to your question.

Mr. **BAILEY**. Well, it is interesting food for thought, though, isn't it?

You mentioned retaliation.

Mr. **REHM**. I think I now understand your term.

Mr. **BAILEY**. Of downstream dumping?

Mr. **REHM**. Yes.

Mr. **BAILEY**. I think it is a problem. We had some testimony yesterday from a fellow by the name of Fox who represented the National Association of Manufacturers. What I am really getting at, of course, is industrial policy and not simply what happens once the automobile is imported and when it is sold here, which is what you deal with, of course.

I think you voice your concerns very well; but I just do not think you have gone deep enough in terms of what I view some of our problems to be. I think as a result of industrial policies, so to speak, there are some Americans—I happen to be one—who think there is more to free enterprise than simply a bill of lading, and that the problems go much deeper than that.

I just make one comment: You did talk about retaliation. You raised a question. You said what if aircraft, for example, manufactured in the United States. Are you aware of local content requirements in Japan for American aircraft manufacturers? Are you aware of that issue?

Mr. **NIELD**. The only awareness I have relates to military aircraft in which the Japanese Government apparently feels that it requires for its own security some assurance of parts availability to support them. When it comes to——

Mr. **BAILEY**. With all due respect, if the Japanese interest in defense were to exceed insistence on domestic content as a cornerstone of defense, I would be very happy with their defense policy. It is sort of an irony. It is sort of a hypocrisy if you are familiar with some of the arguments made about Japanese defense spending.

They are up against public opinion in their country. It has to be said the defense of the Japanese, because of the Second World War, the reactions, that kind of thing since then and we have been, in my opinion, partly responsible for it, too. It cannot be blamed completely on the Japanese.

The attitude toward defense spending is a cautious and careful one in that country. I would rather see here—and I make a lot of enemies in Japan in saying this—I would rather see the Japanese armed to a much greater extent. I have a great deal of confidence in their political system, in them. I think they are a great people.

I would like to see it. I think that would do a good bit to relieve some of the pressure and criticism in this country about bills like this. That is something the Japanese have to resolve and we as Americans cannot. That is their business.

I did want you to know in the commercial area also that there have been complaints of pressures for domestic and local content requirements in manufacturing, ownership, et cetera, and they were voiced, I think, most effectively in this subcommittee by other members.

I think Mr. Jenkins from Georgia, in particular, made an issue of it. I want to make you aware of that. In terms of your testifying, you may want to be aware of that.

Mr. **Nield**. In that regard, sir, I have a son at Boeing who recently sent me a letter, an article from the Boeing Company newspaper. It does deal with the question of the Japanese procurement of the 767. It indicates their relationship with Japan Airlines, for instance, provides for Japan Airlines to specify certain kitchen equipment and certain seat designs which they do for all airline customers. They have no local content requirement whatsoever that the company must meet.

Mr. **Bailey**. I don't pretend to have all the details in that case. I know when we had the remarks before the committee, Mr. Jenkins made them; he made reference to some very stiff and severe local content requirements. I don't know if they are like what our automobile people are confronted with when they tried to sell there.

Mr. **Nield**. It might be useful to record this for the record since it does deal precisely with the question you ask.

Mr. **Bailey**. That's the Chairman's decision.

Chairman **Gibbons**. Fine with me.

Mr. **Frenzel**. Mr. Chairman, I ask unanimous consent it be made part of the record.

[The document referred to follows:]

September 2, 1982

BOEING NEWS

Overseas procurement is small, relative to foreign-sales return — notes group of Boeing execs

by Barry Ramsberg

Selling airplanes internationally is a two-way street, but for Boeing the exported airplanes are a sales superhighway, and the imports necessary to ensure the export sales are a small footpath.

The relative size of these exports and imports — imports amount to about 4 percent of the value of Boeing airplanes, excluding engines and other normally purchased equipment — was discussed last week with senior Boeing officials.

Prompting the interviews were statements by local and national union leaders that some 40 to 60 percent of Boeing airplane manufacturing jobs go overseas.

"Statements of this kind may be misleading to Boeing employees and the public," said E.H. "Tex" Boullioun, Boeing senior vice president, commercial airplanes.

"They also fail to mention the importance of foreign sales to American jobs," he said. "For the past three years, Boeing has been the No. 1 export company in the United States.

"As a matter of fact," Boullioun said, "only about 4 percent of the value of Boeing airplanes that have been or will be delivered from 1979 through 1985 is represented by foreign-sourced airframe components. This is apart from engines and other equipment that we normally purchase rather than make ourselves.

"If engines and these other purchased items are included, the imported value in our airplanes increases to about 7 percent."

Boullioun said that about 60 percent of actual and expected Boeing jetliner deliveries from 1979 through 1985 will go to foreign airlines, assuming the Export-Import Bank provides competitive financing.

(Continued on Page 4)

Overseas procurement is small, relative to foreign-sales return, note Boeing executives

(Continued from Page 1)

"Forty percent of those foreign deliveries, or about 24 percent of total deliveries, are sales that probably would not have been made without some sort of foreign procurement," he said.

"International sales are very important to Boeing, and a relatively small amount of work goes overseas in order to get those sales.

"Getting 24 percent of our business volume in exchange for 4 percent of the work is a pretty good trade-off."

"There is a parallel to this in the military field," said Clyde Skeen, Boeing senior vice president responsible for military programs.

"Witness the NATO Airborne Warning and Control System and our current effort to sell the AWACS to France," Skeen said.

"As supplied to the U.S. government and Saudi Arabia, the AWACS is almost totally American-made."

"But as it is supplied to NATO, it is about one-fifth foreign and four-fifths American. Basically, we supply the airplane and most of the electronics, and Europe supplies and installs the rest of the electronics.

"If we hadn't reached an agreement to pass that business to the NATO countries, there wouldn't have been a NATO AWACS. The same goes for the possible French contract now under discussion.

"Sharing the work," Skeen said, "is the only way of doing business with a foreign government buying from U.S. industry that wants to put its own technology and labor into the military hardware it is buying."

Boeing Controller Art Lowell discussed the relations of sales and foreign procurement to jobs.

"We know the number of Boeing jobs that support our various programs, and this number about doubles when our suppliers are taken into account," Lowell said.

"At today's prices, each billion dollars in Boeing sales means approximately 10,000 Boeing jobs for a year and another 10,000 jobs for our various suppliers," he said. "Hourly jobs are about 40 percent of this total.

"Almost half of our purchases are engines, equipment and other non-airframe items that would always be subcontracted. We normally go to outside sources for a portion of the airframe structure work, in order to provide a more effective utilization of our total resources."

The remaining jobs that Boeing "exports" to generate business with foreign customers is only a small fraction, Lowell said.

"Our foreign purchases don't mean a loss of Boeing jobs," he said. "They help to create them."

"Commercial airplane foreign procurements," Boullioun said, "are made for three main reasons.

"The reasons are customer source selection, satisfaction of offset demands and risk-sharing foreign participation to maintain market access and reduce Boeing investment requirements.

"These procurement arrangements are necessary to obtain or clear the way for many foreign commercial aircraft sales," Boullioun said.

"The best example of a customer-selected source of supply is the airplane power plant. Rolls-Royce manufactures engines for the 747 and 757, and the French company SNECMA is a partner with General Electric in CFM International, which makes the CFM56 engine for the new 737-300 and also for re-engining the KC-135.

"A foreign customer may also want optional equipment manufactured by a closer source, or he may ask us to use a particular galley manufacturer that he prefers. Boeing has no control over the customer's decisions.

"Offsets," Boullioun said, "are a requirement imposed as a condition of the foreign government's approval of a sale. Without an acceptable commitment, there is no sale.

"There has been some progress in international agreements to restrict this practice, but we are living with prior commitments, and the practice is still active in certain countries.

"Usually, offsets involve providing opportunities for foreign firms to compete with others for Boeing work."

Boullioun said that some 14 percent of Boeing foreign sales involve offset commitments.

"Risk-sharing participation," he said, "which we have only on the 767, was entered into without any formal understanding that sales would result, but with the expectation that Boeing's competitive position might be enhanced."

Because of the participation in assumption of 767 market risk by Japan's Civil Transport Development Corporation and Italy's Aeritalia, that airplane has the highest portion of foreign procurement, Boullioun said.

An all-new airplane like the proposed 150-passenger 7-7 may also involve similar types of risk-sharing participation, which may make the difference as to whether Boeing competes for that market, he said.

"We may not like it," said Wallace Buckley, Boeing Commercial Airplane Company vice president for program operations, "but foreign governments want a piece of the action for their industry when the airlines they own buy an airplane.

"What we do is make sure that our product quality, schedule and cost are not compromised.

"We have one procurement policy that applies equally to domestic and foreign suppliers," Buckley said. "They must be qualified and go by our rules or there is no business.

"We don't give anybody business; it has to be earned," he said.

"Our experience with foreign sources is generally pretty good," Buckley said. "Once they understand our system and what things are not negotiable, we have found that their deliveries and prices are as good as their U.S. competitors'.

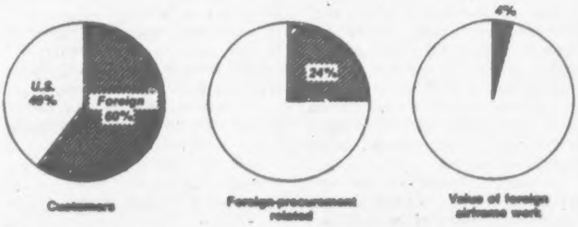
"This involves some extra Boeing effort because of distances, language and other differences," Buckley said, "but it is all part of international trade.

"We do it to help make sales, but we do it in a way that will not hurt Boeing or our customers.

"And by making those sales, we generate jobs, not only at Boeing, but throughout the United States."

BOEING NEWS September 2, 1982

Boeing commercial-jet sales value, 1979-1985 deliveries



Sixty percent of Boeing commercial-airplane sales are expected to be delivered to non-United States customers from 1979 through 1985. Twenty-four percent of the total sales will probably depend on some degree of foreign procurement of airplane components. This procurement will amount to some 4 percent of the airframe value. "Getting 24 percent of our business volume in exchange for 4 percent of the work is a pretty good trade-off," said E.H. "Tex" Boullioun, Boeing senior vice president, commercial airplanes.

Mr. **Bailey**. Maybe you want to send a copy of that to Mr. Jenkins. He made a point of that during the hearings.

In any event, I guess the people that are promoting this legislation, to make a long story short, are concerned with some of the broader policy implications, that kind of thing.

So I thank you for your statement. I think it is very well put together. I don't agree with some of the conclusions you reach in it. I think they are very subject to questioning; but you may not have the experience or resources to get into some of the related questions. I recognize that. I thank you very much.

Did you have something?

Mr. **Rehm**. No.

Mr. **Bailey**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Frenzel?

Mr. **Frenzel**. Thank you, Mr. Chairman.

Thank you for your testimony. I appreciate hearing from you. I was interested in your testimony.

On page 6 of your testimony, you indicated you have already seen a retail price increase caused by Japan's voluntary restraints.

The day before yesterday, Mr. Caldwell of the Ford Co. indicated to us that it was his impression that those voluntary restraints did not result in price increases. Can you explain how you came to your conclusion and what phenomena you noticed?

Mr. **Nield**. You might like to ask that question of Mr. McElwaine, who will appear before your committee in a few minutes. Mr. McElwaine did arrange for a study to be made of that very question and arrived at a figure of $1,900 per car. There are some factors that are in that number that you may agree with or not, which would have some impact on the dollar price, but it seemed very clear to us that there is a significant price increase, perhaps not to that extent, but a price increase that certainly would affect the level of purchase of cars from consumers, by consumers.

Mr. **Frenzel**. Was it observable in terms of an upgrading of models since they were limited to a certain number of units? How did it work?

Mr. **Nield**. This study that was made by the American International Automobile Dealers Association, did establish there was some upgrading of the quality level of the automobiles since the volume of cars to be sold was going to be less, it was quite natural that the quality of the cars in terms of the price range should increase as well.

Mr. **Frenzel**. You still get to the case of wanting a bottle of bourbon when it's short?

Mr. **Nield**. That's correct.

Mr. **Frenzel**. That was my impression, too. I admit the prices of U.S. cars did not skyrocket as I expected them to during that period. I think the price of imported cars did. I am glad to hear you corroborate it.

Mr. **Nield**. I think there was an increase in anticipation of the voluntary agreement as well that would not be——

Mr. **Bailey**. Would the gentleman yield?

The question you said, if I caught it correctly, was the price of imported automobiles rose as a result. Did that have anything to do with the market, concentration on the type of market product, a higher quality car, for example?

Mr. NIELD. Yes. That was the question Mr. Frenzel raised. Part of the increase in price would have been a higher quality car in the price range structure.

Mr. FRENZEL. The point, of course, is that the customer maybe didn't want that high quality car, he wanted the good old cheap one he was buying last year?

Mr. NIELD. That is correct.

Mr. FRENZEL. But we are going to see he gets quality at any cost, as long as it is his.

You have indicated that this is not a proper kind of thing for us to do. The advocates of the bill, on the other hand, indicate that we have to send some kind of message to Japan about how tough we are and that that is going to make them roll over.

Can you tell us what kind of a message you think this sends to Japan and to everybody else in the trading world?

Mr. NIELD. First of all, I think the message would be primarily a message to the world that the United States has abandoned its traditional leadership in fair trade and has given up the confidence in the GATT system, returned to a beggar thy neighbor approach, in the direction of Smoot-Hawley.

I think such a radical change in trade policy would encourage other countries to adopt similar measures. The United States, after all, is a leader in the world with regard to trade matters. When we make a change in direction, you might expect other countries will do the same.

As far as Japan is concerned, I think the message we would send to Japan is that they could no longer invest in the United States with confidence from an economic, viability of investment point of view.

Mr. FRENZEL. Thank you very much, sir.

Mr. MILLET. Mr. Frenzel, may I supplement Mr. Nield's answer a little bit? As you heard, I represent a Swedish manufacturer. I can say to you very frankly from the point of view of my company, the passage of such legislation would certainly inhibit some plans we have for investing not in building passenger cars but in building another vehicle in the United States.

You would sit back, look at it, and say if the United States is going to pass this type of legislation today, why should we invest $200 or $300 million in a new factory to build trucks, buses, whatever it may be. We would say maybe they will change again in the future; let's invest the money somewhere else.

Mr. FRENZEL. Tell me the name of that company.

Mr. MILLET. Saab.

Mr. FRENZEL. You would join a long list of people who won't invest here and create American jobs if we pass this bill.

Chairman GIBBONS. And we sure need the buses.

Mr. FRENZEL. It is good to have that information.

The question of this Boeing thing has been raised a time or two during our discussions here. Mr. Bailey just discussed it with you.

Mr. Chairman, I wonder if we shouldn't make some inquiry of the Boeing Co. as to what the situation was, or from the Department of Defense, or the Department of Transportation, or somebody?

We often have more myth, allegory, and anecdote in these sessions than we get honest weight. Let's hear from the people who made the deal. There is some suggestion——

Mr. BAILEY. I support the gentleman in that.

Mr. FRENZEL. There is some question as to whether Boeing's voluntary action was as voluntary as Japan's was in restraining all shipments to the United States. We may never get that kind of information. I think it would be valuable to have. We have had two sides of the same story displayed on the record.

On page 8 of your testimony, you talk about our surplus trade in goods and services. That is a point our chairman has been making ad nauseum, but he hasn't nauseated anybody with it yet because nobody listens to him.

Do you want to explain that so the world will know the difference between merchandise trade and trade in goods and services and on which side of the bread the butter really lies?

Mr. NIELD. Yes. With the balance in merchandise trade, of course, we are doing less well than we are in the combined trade and services. In services, of course, we have a substantial surplus.

But, after all, the flow of money across the borders would encompass both and quite properly when you are talking about one, you should talk about the other as well.

The information that I drew from here was from the Economic Report of the President for 1982. I do have a copy of that table. I would be happy to submit this for the record if the chairman would choose.

Chairman GIBBONS. Certainly. We will put it in the record at this point.

Mr. FRENZEL. I would like to have that in the record.

[The table referred to follows:]

Economic Report of the President (1982)

NATIONAL INCOME OR EXPENDITURE

TABLE B-1.—*Gross national product, 1929–81*

[Billions of dollars, except as noted; quarterly data at seasonally adjusted annual rates]

Year or quarter	Gross national product	Personal consumption expenditures	Gross private domestic investment	Net exports of goods and services			Government purchases of goods and services					Percent change from preceding period, gross national product[1]
				Net exports	Exports	Imports	Total	Federal			State and local	
								Total	National defense	Non-defense		
1929	103.4	77.3	16.2	1.1	7.0	5.9	8.8	1.4			7.4	6.5
1933	55.8	45.8	1.4	.4	2.4	2.0	8.2	2.1			6.1	−4.2
1939	90.9	67.0	9.3	1.2	4.6	3.4	13.5	5.2	1.2	3.9	8.3	7.0
1940	100.0	71.0	13.1	1.8	5.4	3.6	14.2	6.1	2.2	3.9	8.1	10.0
1941	125.0	80.8	17.9	1.5	6.1	4.7	24.9	16.9	13.7	3.2	8.0	25.0
1942	158.5	88.6	9.9	.2	5.0	4.8	59.8	52.0	49.4	2.6	7.8	26.7
1943	192.1	99.4	5.8	−1.9	4.6	6.5	88.9	81.3	79.7	1.6	7.5	21.3
1944	210.6	108.2	7.2	−1.7	5.5	7.2	97.0	89.4	87.4	2.0	7.6	9.6
1945	212.4	119.5	10.6	−.5	7.4	7.9	82.8	74.6	73.5	1.1	8.2	.9
1946	209.8	143.8	30.7	7.8	15.1	7.3	27.5	17.6	14.8	2.8	9.9	−1.2
1947	233.1	161.7	34.0	11.9	20.2	8.3	25.5	12.7	9.0	3.7	12.8	11.1
1948	259.5	174.7	45.9	6.9	17.5	10.5	32.0	16.7	10.7	6.0	15.3	11.3
1949	258.3	178.1	35.3	6.5	16.3	9.8	38.4	20.4	13.2	7.2	18.0	−.5
1950	286.5	192.0	53.8	2.2	14.4	12.2	38.5	18.7	14.0	4.7	19.8	10.9
1951	330.8	207.1	59.2	4.4	19.7	15.3	60.1	38.3	33.5	4.8	21.8	15.5
1952	348.0	217.1	52.1	3.2	19.1	15.9	75.6	52.4	45.8	6.5	23.2	5.2
1953	366.8	229.7	53.3	1.3	18.0	16.7	82.5	57.5	48.6	8.9	25.0	5.4
1954	366.8	235.8	52.7	2.5	18.7	16.2	75.8	47.9	41.1	6.8	27.8	.0
1955	400.0	253.7	68.4	3.0	21.0	18.0	75.0	44.5	38.4	6.0	30.6	9.0
1956	421.7	266.0	71.0	5.3	25.0	19.8	79.4	45.9	40.2	5.7	33.5	5.4
1957	444.0	280.4	69.2	7.3	28.1	20.8	87.1	50.0	44.0	5.9	37.1	5.3
1958	449.7	289.5	61.9	3.3	24.2	21.0	95.0	53.9	45.6	8.3	41.1	1.3
1959	487.9	310.8	78.1	1.4	24.8	23.4	97.6	53.9	45.6	8.3	43.7	8.5
1960	506.5	324.9	75.9	5.5	28.9	23.4	100.3	53.7	44.5	9.3	46.5	3.8
1961	524.6	335.0	74.8	6.6	29.9	23.3	108.2	57.4	47.0	10.4	50.8	3.6
1962	565.0	355.2	85.1	6.4	31.8	25.4	118.0	63.7	51.1	12.7	54.3	7.7
1963	596.7	374.6	90.9	7.6	34.2	26.6	123.7	64.6	50.3	14.3	59.0	5.6
1964	637.7	400.5	97.4	10.1	38.8	28.8	129.8	65.2	49.0	16.2	64.6	6.9
1965	691.1	430.4	113.5	8.8	41.1	32.3	138.4	67.3	49.4	17.8	71.1	8.4
1966	756.0	465.1	125.7	6.5	44.6	38.1	158.7	78.8	60.3	18.5	79.8	9.4
1967	799.6	490.3	122.8	6.3	47.3	41.0	180.2	90.9	71.5	19.5	89.3	5.8
1968	873.4	536.9	133.3	4.3	52.4	48.1	199.0	98.0	76.9	21.2	101.0	9.2
1969	944.0	581.8	149.3	4.2	57.5	53.3	208.8	97.6	76.3	21.2	111.2	8.1
1970	992.7	621.7	144.2	6.7	65.7	59.0	220.1	95.7	73.6	22.2	124.4	5.2
1971	1,077.6	672.2	166.4	4.1	68.8	64.7	234.9	96.2	70.2	26.0	138.7	8.6
1972	1,185.9	737.1	195.0	.7	77.5	76.7	253.1	101.7	73.1	28.5	151.4	10.1
1973	1,326.4	812.0	229.8	14.2	109.6	95.4	270.4	102.0	72.8	29.1	168.5	11.8
1974	1,434.2	888.1	228.7	13.4	146.2	132.8	304.1	111.0	77.0	33.9	193.1	8.1
1975	1,549.2	976.4	206.1	26.8	154.9	128.1	339.9	122.7	83.0	39.7	217.2	8.0
1976	1,718.0	1,084.3	257.9	13.8	170.9	157.1	362.1	129.2	86.0	43.2	232.9	10.9
1977	1,918.0	1,205.5	322.3	−4.2	183.3	187.5	394.5	143.9	93.3	50.6	250.6	11.6
1978	2,156.1	1,348.7	375.3	−.6	219.8	220.4	432.6	153.4	100.0	53.4	279.2	12.4
1979	2,413.9	1,510.9	415.8	13.4	281.3	267.9	473.8	167.9	111.2	56.7	305.9	12.0
1980	2,626.1	1,672.8	395.3	23.3	339.8	316.5	534.7	198.9	131.7	67.2	335.8	8.8
1981 p	2,922.2	1,858.1	450.6	23.8	366.7	342.9	589.6	228.6	153.3	75.2	361.1	11.3
1979:												
I	2,340.6	1,454.1	408.3	19.9	259.1	239.2	458.2	164.8	106.0	58.8	293.4	12.7
II	2,374.6	1,478.0	423.2	8.2	266.8	258.6	465.1	163.6	108.1	55.5	301.6	5.5
III	2,444.1	1,529.1	421.7	17.9	293.1	275.2	475.4	165.1	112.0	53.1	310.4	12.2
IV	2,496.3	1,582.3	410.0	7.6	306.3	298.7	496.4	178.1	118.7	59.4	318.3	8.8
1980:												
I	2,571.7	1,631.0	415.6	8.2	337.3	329.1	516.8	190.0	125.0	64.9	326.8	12.6
II	2,564.8	1,626.8	390.9	17.1	333.3	316.2	530.0	198.7	128.7	70.0	331.3	−1.1
III	2,637.3	1,682.2	377.1	44.5	342.4	297.9	533.5	194.9	131.4	63.5	338.6	11.8
IV	2,730.6	1,751.0	397.7	23.3	346.1	322.7	558.6	212.0	141.6	70.4	346.6	14.9
1981:												
I	2,853.0	1,810.1	437.1	29.2	367.4	338.2	576.5	221.6	145.2	76.4	354.9	19.2
II	2,895.[illegible]	1,829.1	458.6	20.8	368.2	347.5	577.4	219.5	148.2	71.3	357.9	4.7
III	2,965.[illegible]	1,883.9	463.0	29.3	369.0	338.7	588.9	226.4	154.1	72.2	362.5	11.4
IV p	2,984.[illegible]	1,909.5	443.6	16.0	363.0	347.1	615.7	246.7	165.8	81.0	369.0	2.7

[1] Changes are based on unrounded data and therefore may differ slightly from changes computed from data shown here.

Source: Department of Commerce, Bureau of Economic Analysis.

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Mr. FRENZEL. I think it is not well understood. It is difficult to read trade reports. In every statistic we have, there are things we don't expect to be in there that we maybe wouldn't count if we were totaling up trade, investments, repatriation of dividends, et cetera. But it is good to spread the record that all is not gloom and that the United States has been, I suspect, the principal world beneficiary of the trading system that was inaugurated or at least became codified right after World War II that we called GATT.

Chairman GIBBONS. Will the gentleman yield?

Mr. FRENZEL. I do yield.

Chairman GIBBONS. I said the other day one of the cheap shots we all take at each other around here—and I note I have taken a few, too—is to overstate your opposition's position. I kind of sit back when people overstate mine and laugh because I know what they are doing; but as I see it, we only trade to improve our position. We don't trade for any other purpose.

We trade to live, not live to trade. There is nothing sacred about trade. We only trade because it is in our self-interest. Then there are people who say oh, you want to make a service economy out of the United States. I don't want to make a service economy out of the United States or anyplace, really.

I want to make whatever economy they can profit by, as long as it is conducted on an even field; with evenly applied rules. I don't see anything bad about improving our status in services. Services perhaps are our renewable resource. It is our brain power that we are exchanging for the best price we can get for it. It is our intelligence.

We are not sending away some nonrenewable resource that we won't have some time in the future. We are not trading our petroleum, a finite resource. We are not even trading our iron ore, a finite resource, or any of our other finite resources that we have. We are trading what we have learned and our intelligence.

So I do not try to make a service economy out of the United States. I just think I go back to my military training. One of the basic lessons they taught us was, don't waste your time reinforcing your failures; don't give up your human resources in reinforcing your failure; exploit your successes.

I think that is what America's philosophy ought to be. So I enjoy this conversation.

Mr. FRENZEL. Thank you, Mr. Chairman.

As I understand your organization—we used to call that plowing the fertile field first.

As I understand your organization, you sell cars of all kinds in this country; all sorts of foreign manufacture?

Mr. NIELD. That is correct.

Mr. FRENZEL. It would seem to me that you would have as many dealers who are selling European cars which would be likely advantaged in a market which made it more difficult for the Japanese to sell in this country? Was your organization unanimous in its adoption of this policy statement? It seems some would have something to gain from an inhibition of Japanese sales.

Mr. NIELD. That is a very interesting point, as a matter of fact. As I mentioned, we do represent 17 Japanese and European companies, 7 of which are Japanese, 10 are European; only 3 or 4 of them are actually impacted directly by this legislation.

However, when the AIA board of directors discussion took place with regard to our position on this bill, there was a unanimous opinion and enactment of a resolution of the board of directors that we should be doing everything we possibly could to discourage the enactment of this bill because the members saw it as a significant threat to international trade and their whole future, as they saw it, was related to international trade.

It is a much bigger issue than just the near-term profit of certain companies versus others.

Mr. **Frenzel**. There is no question about it. As soon as we took care of Japan, we would take care of the others one at a time; then the radios, the tires. You have to protect everybody.

I thank you for your testimony. I think it has been very helpful. I particularly like your summary statement. It is a good litany for all of us to remember.

Chairman **Gibbons**. Mr. Bailey?

Mr. **Bailey**. The gentleman representing the Swedish company, are you from Sweden?

Mr. **Millet**. No, I am not. I am an American. I have worked for Saab about 30 years.

Mr. **Bailey**. Have you been over there?

Mr. **Millet**. Many, many times. I was over there 2 weeks ago.

Mr. **Bailey**. What would you suggest we do? Is there a steel company, Ingersohl? What is the name of it?

Mr. **Millet**. There are steel companies. Eskahv is in the steel business.

Mr. **Bailey**. A number of them have been recipients of government loans on which they do not have to pay back interest or pay back the principal unless they become profitable.

What would you suggest we do about that?

That supposedly has nothing to do with free trade.

Mr. **Millet**. I am not sure I am in a position to speak to that question. I do not know of any cases in Sweden where the Swedish Government has given interest-free non-paid-back loans. There have been cases, I know, where the Swedish Government has taken over the steel company that was about to go bankrupt, but I do not——

Mr. **Bailey**. Is that an interference with free trade?

Mr. **Millet**. I presume you could call it that.

Mr. **Bailey**. The chairman talked about reinforcing our failures. Are we supposed to receive product lines that have to do with reinforced failures?

Mr. **Millet**. Sweden has, as you probably know, a strongly socialistic government.

Mr. **Bailey**. Yes, sir, I do know that.

Mr. **Rehm**. Mr. Bailey, I don't think there is anything inherently unfair in government ownership of a manufacturing facility.

Mr. **Bailey**. Don't say that to your clients. Make sure you put meat on those bones.

Mr. **Rehm**. I am saying per se. I am happy to say the Department of Commerce has understood and accepted this in construing the countervailing duty law. Per se there is nothing wrong about government ownership of a productive facility.

The question is, How is the government behaving in the management and running of that company?

Mr. **Bailey**. Do you have any information on that situation?

Mr. **Rehm**. In Sweden? No, I do not, but I did not want to leave the suggestion that mere government ownership is per se——

Mr. **Bailey**. I didn't make that suggestion. That was your assumption, I think.

Mr. **Rehm**. Our point is that there are rules, international rules, that are prescribed by the GATT and codes. We feel very strongly it is in the interest of the United States as well as other countries to abide by those rules.

This bill would violate the GATT as fundamentally as you can.

Mr. **Bailey**. I know that. You have very strong feelings against dumping, for example?

Mr. **Rehm**. Injurious dumping? Yes. We have statutes to deal with that.

Mr. **Millet**. Mr. Bailey, I don't think any of the Swedish companies have been accused of dumping. Not that I am aware of.

Chairman **Gibbons**. Not that I know of.

Mr. **Rehm**. Not recently.

Chairman **Gibbons**. Or in the recent steel cases, Don, I don't believe I recall a single complaint against the Swedes.

Mr. **Rehm**. That is correct, Mr. Chairman.

Mr. **Bailey**. I didn't say they did. I enjoyed very much the quick jump to their defense. I think the point I am trying to make is that these constant discussions and all the rhetoric that we devote to so-called free trade, as if it is some kind of border or port transaction that exists in a vacuum is naive, is improper, is incorrect, is foolish, is going to lead to all kinds of angry public and political reactions until we start addressing some of the root cause issues that lead to legislation like this.

I have made a consistent point before the committee—in fact, I haven't heard anyone who is a proponent of this bill say they view it as any kind of ideal thing. In fact, they criticize it much the way you gentlemen have, but they feel we have to do something to respond to a frustration.

I would have to say the point you are making here I don't think even needs to be made.

Mr. **Rehm**. I was just saying to George, if that is your position, then perhaps we could all agree that constructive measures——

Mr. **Bailey**. What are they? I asked you before. I asked you the first time I questioned you.

I raise issues of dumping. I raise issues of subsidization. You seem to be so—wait a minute—you seem to be so darned attached to the GATT. I am too.

I think subsidization needs to be redefined. We just cannot talk about these problems as if somehow the United States is out here, unilaterally violating this wonderful, beautiful, euphoric world of free trade that we are going to, in our confusion and stupidity, upset, and that we are somehow going to subject these poor foreign nations to make them victims of the selfish policy on our part.

That is just not the way the public perceives it. I guess I am just raising a political question.

I think the technical objections you folks raise about the GATT and what-not that you folks raised in particular are correct, if you study the legislation.

I guess what I am trying to say is, I think we need to start talking about some of the root causes of why there is a public reaction of this sort and why it does not fall on deaf ears.

It is just not that simple.

Mr. REHM. May I make two points?

First, we are not making technical points, Mr. Bailey. We are saying in our judgment this is a destructive bill in terms of the national interest overall. We are speaking in terms of what is best for the interests of the United States; only secondarily other countries. We believe for all the reasons we have given that this is, on balance, a highly destructive bill.

Point two, the GATT is certainly imperfect; there are lots of deficiencies; it needs lots of reform, but why did the United States work so hard for so many years in the most recent Tokyo Round to negotiate——

Mr. BAILEY. Why, sir, is the United States having so much difficulty in having other countries observe what it means?

Mr. REHM. Not at all. What are the steel proceedings all about? That is a major effort——

Mr. BAILEY. Do you have any idea or knowledge, sir, of what has gone into the history of trying to get those cases filed?

Mr. REHM. Yes.

Mr. BAILEY. Of trying to get the information.

Mr. REHM. I am intimately involved, representing a German manufacturer.

Mr. BAILEY. You can't say for 1 minute we are not talking about a dumping situation there. What about the Mitsui case?

Mr. REHM. You are going too fast for me, Mr. Bailey.

Mr. BAILEY. I thought you were familiar with those anti-dumping cases. I guess what I am saying to you is there is a public who is very angry, it is reacting.

Mr. REHM. Are they reacting to the right thing, Mr. Bailey? That is the question.

Mr. BAILEY. I don't think they are, technically, no. I just don't know where else to turn. You try to make recommendations. I happen to agree with your conclusions. This is not the best way to go.

I have made that statement many times. I can't disagree with you.

Mr. REHM. Do you cure a problem by a destructive bill, Mr. Bailey?

Mr. BAILEY. Why not give me an alternative? Do you have ideas what to do about this? What about market entry in Japan? What should we do there?

Mr. REHM. If the U.S. automobile manufacturers are sincerely interested in the Japanese market—may I finish my answer——

Mr. BAILEY. You know, I was interrupted about three times before you chimed in, my good friend. Tit for tat.

Mr. REHM. Go ahead.

Mr. **Bailey**. Thank you very much. Very kind of you.

We are talking about a problem that exists on a very broad scale. That is my question.

I have talked to American automobile manufacturers. There were those that tried very, very hard, at least in their opinion, to try to penetrate the Japanese market or even manufacture there or invest there.

Are you going to sit here and tell us that that Japanese system is as open across the board as this one is, and I am not trying to be unfair to you—I guess that is the point I am making.

I don't think it is fair and open. If I am wrong, tell me. If you have experience, tell me.

Mr. **Nield**. If you are talking about automobiles, perhaps I could answer that question. I am somewhat familiar with that situation.

I do think the Japanese automobile market is very, very open in Japan or the United States or Germany or whatever other country you wish to seriously export cars to Japan.

They do have safety and emission standards in Japan just like in the United States. They do have provisions for certification for cars to meet those standards just like in the United States.

As a matter of fact, their system is very much similar to the system used by the U.S. Government in certifying emissions standards for cars coming into the United States.

Mr. **Bailey**. You would say automobile marketing in Japan is as free and open as the marketing of the finished product as in the United States?

Mr. **Nield**. I say it is very, very similar. There are some Japanese peculiarities, perhaps, but there are certainly American peculiarities as well.

Mr. **Bailey**. You may be right.

Let me say, you are the only person I have ever heard make that statement. I have never sold a car there. I don't know. You seem to be very sincere to me.

Mr. **Nield**. One reason I was anxious to respond to that is that I have heard it said, during this series of hearings, in fact, that cars must be inspected individually in Japan where, of course, a model certification is appropriate in this country. That is misleading because in Japan they have an optional system.

You can get certification of the complete model just like you can sending cars into the United States. So there really isn't a difference there as has been described.

Mr. **Bailey**. I have had Volkswagen, the most successful seller in the Japanese market, say that they have difficulty.

They sold 10,000 units out of a total of 40,000 units sold in Japan.

Furthermore, they say for many years they were totally excluded and I must say to you I do not know why, you know, if there is such a quality or total quality difference, they say they have difficulty investing there for manufacturing purposes.

They said the National Association of Manufacturers said that they had difficulty borrowing money there on a fair basis. They say it is not an open system. Everybody says it is not. You say it is. I don't know.

Mr. **Nield**. I think it is a tough market because they do manufacture cars right there that are excellent cars. If you are going to go into a market like that, you will have a tough time being successful.

It is not a government-interference type of thing.

Mr. BAILEY. For many years you couldn't sell a car there.

Mr. NIELD. We are talking about the present situation. In the past it may have been different.

Mr. BAILEY. I mean we got to this point in time somehow.

What about currency? You haven't responded to currency. Do you have any experience with that? Currency valuation?

Mr. NIELD. That is certainly an important factor. I noticed in the discussions earlier there seems to be some bewilderment about what to do about it or what causes the relationship. I don't have that answer. I am sorry.

He wants me to answer a question you haven't really asked yet. If we think this bill is bad and the industry truly is having problems and we are sympathetic to those problems, what would we suggest that might be done instead of pursuing this legislation?

Mr. BAILEY. I have been asking that question the whole session. I have asked you for alternatives a number of times.

I asked for it generally when the gentleman here became distraught or upset a little bit.

What should we do about this situation, because we have an awful lot of people complaining. I don't think they are evil people or bad people. I do not think this reaction of the United States is simply a response to fair and even competition. I won't argue, incidentally, the quality issue.

I don't argue the druthers issue.

I would druther this bill wasn't out there, but I have asked for some kind of response. We don't have an industrial policy. We are not competitive in terms of capital formation costs and things of that sort, at least in some ways.

Part of it is inherent in the nature of our system, the way we like to turn a quick profit. It is not a matter of bad Japanese policy or bad American policy.

What do you do overall if you don't deal with this bill?

Mr. NIELD. First of all, this answer does not deal with what you do with the Japanese problem. We don't agree there is a Japanese problem. What do you do with the Detroit problem? We do agree there is a Detroit problem.

First of all, obviously, the overall recovery of the economy is the key factor as far as Detroit was concerned. We were very pleased to hear Mr. Smith——

Mr. BAILEY. It affects you too.

Mr. NIELD. Certainly. No question about that.

We were very pleased to hear Mr. Smith in his testimony this morning express optimism about the recovery of this industry. We think the recovery of General Motors would mean the recovery of Ford and Chrysler as well.

Another thing that the Congress could do specifically, I think, would be to pay some attention to the proposed Clean Air Act amendments which certainly have been a serious problem for the Detroit manufacturers particularly, the import manufacturers as well.

I think, primarily, some attention to the Clean Air Act amendments would be particularly appreciated by the Detroit manufacturers.

I think there should be, perhaps, a review of the corporate average fuel economy requirements. I think it is pretty well established now that the marketplace itself is expressing itself very effectively in what kind of cars people buy and the bureaucratic control of the industry by fuel economy levels is perhaps counterproductive at this point.

There has been frequent concern expressed by domestic manufacturers with regard to their inability to cooperatively engage in research and development among themselves because of antitrust restrictions.

I think that is an area where we could learn from, perhaps, other countries.

Mr. BAILEY. Do you think we need changes in antitrust laws?

Mr. NIELD. Yes.

Mr. BAILEY. I tell you, I am glad to hear you say that.

Mr. NIELD. I think there might be some consideration of tax policies that would benefit exports; perhaps the value added tax could be considered as a means of making the U.S. exports more attractive.

Mr. BAILEY. The chairman brought that issue up a couple of days ago. It was pretty well received. Do you think that is a good idea, to get away from reliance on our income tax system and get more into a value added tax?

Mr. NIELD. I personally do. On some of these points I am not reflecting the unanimous view of the board of directors of our organization. I don't know of any opposition.

Mr. BAILEY. You better watch that.

Mr. NIELD. The last point I would suggest is there is legislation on the export trading company which has not quite cleared the Congress. I think that would be particularly effective for the small companies in the Detroit area, suppliers of parts, for instance, who are hurt because of the lack of activity by the Detroit vehicle manufacturers and could very well provide parts for export if they had the awareness of procedures and so forth, which would be provided by this export trading company legislation.

So I would certainly endorse that.

Mr. BAILEY. Let me finish up with one last question to the gentleman here who dealt with the dumping case. Do you feel the trade laws in existence now, as they are structured, do you think that the discovery techniques, for example, that are available to a complainant are sufficient to deal with the dumping problem? We view dumping as an obnoxious response, and in this country, at least, as a dangerous and politically explosive issue. It is viewed that way. It is probably at the base of all this stuff, by the way. That has been the publicity concerning dumping. We view it as a cause of unemployment, resource disturbance, interference with free trade, ultimately.

Do you think the law as it stands—and if you think it does not, do you have any recommendations at all that—deals adequately with that problem in your experience?

Mr. **Rehm**. You specified the discovery process in particular. Do you want me to answer that?

Mr. **Bailey**. I have had complaints from both the industry and union side that they don't have adequate legal recourse to get the information they need when they show—let's say they go in and show a juror it is very clear on its face that there is an injury here. You know enough about how an industry, for example, makes a ton of steel. You say you just can't make that ton of steel for that price and sell it for that price. There is some problem here.

They have a great deal of difficulty, they say, getting information, getting access to information abroad, for example, that kind of thing; the process is very expensive, cumbersome, takes a great deal of time. I know we don't want to litigate to death, but are those complaints justified in your experience?

Mr. **Rehm**. Not in my experience. This committee was largely responsible for amending the antidumping and countervailing duty statutes to provide for the release of confidential information, pursuant to what is called an administrative protective order, to the complainants. I know, for example, in the steel proceedings the Department of Commerce has agreed to the release, under certain circumscribed conditions, of highly confidential information provided by the respondents, to attorneys representing complainants. So it seems to me that that avenue is now clearly available under the present statute and a failure by the agency to agree to administrative protective orders can now be challenged in the Court of International Trade.

Yes; my answer to your question is I believe that that procedure is adequate today.

Mr. **Bailey**. It is adequate today? You seem to emphasize that.

Mr. **Rehm**. As opposed to what might have been the case under prior statutes.

Mr. **Bailey**. You think there is no reason to write additional protections into the law?

Mr. **Rehm**. If we are talking about access to pertinent and important and confidential information, which I think is what you are talking about, I think the present procedures are adequate.

Mr. **Bailey**. Do you think the times involved in gathering information, do you think the burdens of proof are adequate?

Mr. **Rehm**. Yes, because, of course, essentially it is not an adversary proceeding, as you well know. The complainant obviously has to make out a prima facie case. That standard I don't think is unreasonable. Then it is up to the agency to gather the necessary information to see whether the statutes are met or not. I think Commerce, frankly, if anything, has been quite liberal in accepting antidumping and countervailing duty complaints and not being terribly technical in reviewing their adequacies.

Mr. **Bailey**. Would you say your opinions are widely held in the industry?

Mr. **Rehm**. I am a member of the International Trade Bar, so-called, of Washington. Yes; I have in mind friends of mine who represent petitioners—we represent only respondents—I think they would agree with that. I know, for a fact, they have been successful in having access to confidential information.

Mr. Bailey. Are the damages adequate to prevent that kind of practice or police the system, do you think?

Mr. Rehm. The damages?

Mr. Bailey. The remedies?

Mr. Rehm. The remedies, of course, are antidumping and countervailing duties designed to offset the unfair margin that the foreign producer has acquired. I think if you are asking should there be a punitive duty on top of a compensatory duty, if I may use that term, I would say no.

Mr. Bailey. Why?

Mr. Rehm. Why? Because I think it is sufficient in terms of maintaining international trade, as I understand it, to offset that advantage. That is a sufficient punishment, because thereby the foreign producer is deprived of the advantage he had. That is sufficient. That puts him once again on parity with all of his other competitors.

Mr. Bailey. As a member of the International Trade Bar, are you familiar with and would you have any suggestions at all with the use of—particularly in capital intensive projects—Government financing? Subsidized interest rates? Should they be included within the GATT definition in your opinion? Would you make some recommendations to us in that regard?

Mr. Rehm. Well, I think they already are. Preferential interest rates are subject to countervailing duties.

Mr. Bailey. Has there ever been a case pressed on that?

Mr. Rehm. The Department of Commerce so found in the recent spate of steel proceedings.

Mr. Bailey. What was the country involved in that?

Mr. Rehm. I think preferential interest rates were found—subject to check, Mr. Bailey—in most, if not all, of the Western European countries involved in the steel proceedings. That is my recollection.

Mr. Bailey. What can be done, if indeed anything can be done, to put an end to that kind of practice so that there is some kind of decent, global allocation of, for example, steelmaking resources or automobile manufacturing resources? Are there any ideas out here to try to solve the problem? I don't have any. I don't know. I just view the American reaction as being a reaction basically based on those things. I have had problems with individual products and studied capital intensive industries, in particular, because I was on the Armed Services Committee and very much concerned with basic American industrial capacity and the fact our capital intensive industries are in trouble and most nations have policies which favor some minimal capacity in an area that we really do not. I am not saying that we should develop some type of industrial capacity to deal with those things; but we need to police the system better.

I just wondered if you had any recommendations on how that could be done or do you think it is working well?

Mr. Rehm. As long as we are a world of sovereign nations, which we certainly are today, it seems to me the only approach that I can see is a cooperative one. That cooperative approach, of course, is best reflected in the GATT and the series of agreements that have been negotiated under the GATT. We now have an antisubsidy code and an antidumping code. They, at least, are a deterrent because they pose a very real threat of the imposition of antidumping and countervailing duties if you are caught. Sure, that does not mean everybody is caught, but at least you are under that threat if you are engaging in international trade.

I don't know of a better approach, which is why we feel so strongly about the local content bill. That is a unilateral approach that says to hell with all the rules.

Mr. **Bailey**. We disagree on that point.

Mr. **Rehm**. Doesn't this bill say to hell with all the rules?

Mr. **Bailey**. I don't know if it does. Again I technically agree with you. I think what we have to do is establish a little better standard of free enterprise worldwide. Obviously you are very well formed on these things. That is very impressive. Where I want to take your mind to is to connect some areas where I think this brand of free enterprise here that we like and that we think is pretty efficient is being challenged by these industrial policies so to speak that include a number of different things. They have planning aspects, and I note you are nodding in agreement.

I am sure you probably know more about it than I do, and these credit aspects and those kinds of things. The truth is though—see, I don't think it is working. That is where you and I disagree. I see too much evidence of it not working. World steel oversupplies, not that we are not responsible for helping foster that problem. But it doesn't seem to be working. I think that is creating a pressure. I think this bill is in response to some of that pressure, but you know what the bill is doing, and the Chamber of Commerce said it best yesterday, it is a 2-by-4, getting a hell of a lot of attention. A lot of folks that never looked at the underlying problems are looking at it now.

Mr. **Rehm**. Mr. Bailey, if the system isn't working, why do we have a surplus in our combined goods and services account?

Mr. **Bailey**. I don't know.

Mr. **Rehm**. Wouldn't it suggest that at least superficially, it is working?

Mr. **Bailey**. Here is my concern. My concern is when I sat on the Armed Services Committee, we have a very, very basic need in this country for a vehicle industry. We very badly need that. For military purposes we need that. You and I may disagree but a lot of people think we are dangerously close to perhaps losing irrevocably a major percentage of that capacity; and if possible, if things continue, the possibility of the dissolution possibly and the bankruptcies, possibly, of all of those automobile companies.

Now that may be an exaggeration. I do not know. I have dealt with a number of different problems, for example, in the glass area, when it came to even parts for tanks, machine tools. Are you familiar with the *Houdaille* case?

Mr. **Rehm**. Yes.

Mr. **Bailey**. How do you respond to that, as a business practice? If we have to get in tune that American industrial policy, if you consider antitrust changes part of that picture, I don't know. I am sure you could offer better suggestions than I could. But a lot of people just think in terms of basic business practices—and I happen to be one of them—that we need to make things a little more equal. Maybe I am wrong. If I am, point that out to me. I don't find anybody who disagrees with that. There are disagreements about what to do, but what do you do? You tell me that Japan is as open a market society as this one is. You are very alone in that.

Mr. **Rehm**. In terms of governmental policy, that is a fact. Now I would agree that there are cultural and other factors at work in Japan and that unquestionably make it difficult to sell a car in Japan.

Mr. **Bailey**. Cultural. Just automobiles or the society overall?

Mr. **Rehm**. I would say overall. If we are talking about——

Mr. **Bailey**. Beef, cigarettes, silly little things like that?

Mr. **Rehm**. No; there you have cited examples of clear absolute quotas in violation of the GATT. We don't have such things in violation of GATT in the automotive sector.

Mr. **Bailey**. I didn't mean that, only the automobile sector.

Mr. **Rehm**. Shall we talk about U.S. quotas? It is not black and white. We also maintain a vast number of import restrictions. Textiles alone——

Mr. **Bailey**. How do we compare overall?

Mr. **Rehm**. I don't know how to answer that question. In terms of the average tariff rate, for example, I think we are maybe a little above that of the community. In terms of the volume of trade that is covered by absolute quotas, I couldn't give you the answer; but I don't think we turn out to be all that innocent if you toted them up.

Mr. **Bailey**. We are not totally innocent. That is for sure. If you sat down and looked at the automobile industry per se and looked at it on a worldwide basis overall, would you say that things the way they are today, given the status of our tax laws, there is, marketing procedures, experiences, et cetera, consumer preferences and all those things, do you think that you would make an investment in the American automobile industry? Do you think it is a good investment? A competitive one?

Mr. **Rehm**. Today?

Mr. **Bailey**. Yes.

Mr. **Rehm**. Yes; I think in terms of the long run——

Mr. **Bailey**. Why?

Mr. **Rehm**. For two reasons. Although I am way out of my legal realm at this point, and I will let George and Ralph amplify what I have to say——

Mr. **Bailey**. No; I think you are the best witness we have had before this committee. I am learning from you. I am enjoying it. You are challenging a lot of ideas I have been presented with. I respect your advice. I don't want to get you in trouble with your job.

Mr. **Rehm**. It is just that I do not pretend to be a businessman.

Mr. **Bailey**. Why would you consider it a good investment? I put a lot of things together and it doesn't come out that way to me.

Mr. **Rehm**. Right now admittedly is a bad time. I guess I would give two reasons. First, I would take into account the fact—I believe it is a fact—that we are now temporarily in a very bad economic state. You can call it a recession, a depression, but clearly everything does not look very good. It seems to me in the long run I would have the confidence in the American system and its ability to recover. That is point one. Point two, I do believe, as I think Mr.

Caldwell has said and Mr. Smith of GM, that Detroit does have the inherent capacity to compete if it really wants to. I happen to believe——

Mr. **Bailey**. In our market here?

Mr. **Rehm**. In our market here.

Mr. **Bailey**. What about worldwide?

Mr. **Rehm**. That is less clear. I think that really turns upon, in my judgment, largely how successful the world car strategy will be.

Mr. **Bailey**. What about Japan?

Mr. **Rehm**. In terms of competing with Japan?

Mr. **Bailey**. In Japan's market, yes.

Mr. **Rehm**. In Japan's market? You see, I don't agree with the point you made before that any U.S. automobile company has ever tried to sell in Japan. I think to sell in Japan you have to design a very special car, with special features, it has to be very high quality, and I don't think any Detroit manufacturer has ever done so. Frankly, I don't think Detroit has ever been interested in exporting cars. They have had a huge market, the most affluent in the world, the largest in the world. For what? Three quarters of this century, they had a virtual monopoly. All of a sudden they find themselves, beginning in the sixties and seventies, facing competition for the first time. They did not respond very well. I think now General Motors, Ford, and Chrysler are beginning to. I think they will turn the corner.

Mr. **Bailey**. You think that as a free enterprise model, the Japanese model is OK and it is worthy to emulate, because if it is we better get—well, we better get moving. It is very successful.

Mr. **Rehm**. It is very successful indeed. I am not sure we want to emulate it.

Mr. **Bailey**. Why not?

Mr. **Rehm**. I believe that carries us beyond economic and political policy into cultural issues, ways of life, how things behave and the like. I am not sure I want to be of the Japanese character or temperament, if you will. I think there are a lot of strength left in this country. I agree with the chairman and Mr. Frenzel, I don't think we have to throw in the towel. I don't think we have to give up and say the system isn't working. I think it is still working. God knows there are lots of problems we have to confront as the GATT ministerial meeting may try to do in November.

Mr. **Bailey**. I think this with all due respect: There are too many sectors of this economy that show the same kind of problem the automobile industry has, particularly—I keep harping on it—particularly in major basic industries that require long-term capital investments. There is also an issue—and I mentioned the Houdaille thing, because I am sure with your expertise that you are familiar with it, there are also some issues that have to do with marketing and marketing here. I agree they are cultural; what are accepted marketing or business practices abroad in some cases. But there needs to be some equalization here. In many cases, it is causing a transfer of technology and capital from the United States abroad. I am not sure—I think a lot of it is our fault domestically. I think our domestic policy is very much at the root cause. I want you to know that. I really believe it is. I have introduced a lot of legislation to try to deal with that or fought arguments to try to change that. Some have to do with our concept of free enterprise, though, and the fact we do not want that relationship between government and business that we see in those foreign countries. But it has all led to different domestic policies in respective countries that have pressured the international system. I think in some ways that is why there is such a strong American reaction. I really do believe our system is more open. I think a little better and much freer. I really believe that. I think there are some advantages to that, if we let it operate a little better internationally. It is not that we are without blame, and you are 1,000 percent right.

I will finish by saying this: I don't share your observations of the way the law operates in the countervailing or dumping case situations. We had repeat performances of that problem. I think we need to do something. I think it is a very real problem to go to this issue of industrial policy. I think we need to get at the root cause or we are going to have these kinds of confrontations ad infinitum. We have to improve those basic differences between systems or this is going to continue to be a problem.

Mr. **Rehm**. I think the key question we are all discussing today is how. I would agree there are disparities and discrepancies. The question is how.

Mr. **Bailey**. That is why we disagree on this bill. Incidentally, I think you have done the finest job by far of dealing with issues before this committee. It has been fantastic. I learned a great deal from you. I am grateful to you for it. I don't agree with all your conclusions, but you obviously know what you are talking about. That is a welcome refreshment, believe me.

Mr. **Rehm**. Thank you, Mr. Bailey.

Mr. **Bailey**. I would love to be able to pick your brain.

Mr. Chairman, I want to thank you for being so kind to me with time.

Chairman **Gibbons**. That is perfectly all right.

Mr. **Bailey**. I could feel the glow from your face over here.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Pease?

Mr. **Pease**. Thank you, Mr. Chairman.

Gentlemen, I haven't had a chance to listen to you, but I have read your testimony. Obviously the members of your association have done an excellent job of marketing foreign cars in the United States. Would you be available to take on the assignment of marketing U.S. cars in Japan?

Mr. **Nield**. I think really the answer to that is to have an appropriate car to market in Japan. That is what has been lacking to this time.

Mr. **Pease**. The complaint I hear most often from my constituents is that American cars shipped to Japan sell for at least twice as much, sometimes three times as much as it sells for here in the United States. Can you comment on whether that is an accurate statement; and if so, suggest the reasons why?

Mr. **Nield**. It is an accurate statement, but it is very misleading. The fact is the cars sent from here to Japan are built here to meet U.S. standards. Japan standards are somewhat different as far as safety and emission levels are concerned. There are other adjustments that are required on the cars to operate in Japan. This is all done on an individual basis on the cars after they arrive in Japan. This is, of course, a very expensive process. I think the numbers you have used also have probably included the commodity tax in Japan and which applies to all cars, not just imported cars, but domestically produced cars as well in Japan. That is about a 22-percent tax rate under their commodity tax system. I think this is what accounts for the higher price.

Another point, too, is that cars shipped to Japan are in a very low volume, so that the dealers and others who handle those cars have to make a lot on every individual car because they don't process very many. It is completely a different situation than Japanese cars coming into this country in the quantities that they do and already meeting the U.S. requirements.

Mr. PEASE. If we are looking at a car that would sell in the United States for $10,000 and sell in Japan for $20,000, that is a $10,000 differential. The commodity tax would represent $2,200 of that, as I undestand it.

How much would it cost to change the car over to meet Japanese standards?

Mr. NIELD. I am not in a position to give you a precise estimate on that. It would depend, I would suppose, on what had to be done on that particular model of car to bring it into compliance with Japanese standards.

Mr. PEASE. Would it be in the range of $1,000 a car, $500, $5,000 a car?

Mr. NIELD. It might be useful if we made a study of this and gave you something for the record. That would be more precise than I can get at from here.

Mr. PEASE. Well, you gave me three factors. I am not sure that those add up to a 100-percent increase in the price of the car.

Mr. NIELD. I would imagine the biggest part of the increase would be the marketing costs of the car, the sales commissions, the overhead of the dealership and handling a very small number of cars. It probably would not be that different from, say, a dealer handling Rolls Royce cars or something of a very exclusive nature in this country.

Mr. PEASE. But the Japanese cars sold in the United States, they sell here for appreciably more than they do in Japan or do they sell for less?

Mr. NIELD. They sell for more here than they do in Japan without considering this commodity tax issue. The commodity tax is not paid on the cars exported from Japan, of course, because the commodity tax is like a sales tax; U.S. sales taxes are not charged on cars that are exported either.

Mr. PEASE. So that a car sold in Japan for $6,000 could be exported for $6,000 less 22 percent, is that right? In other words, if a car would sell in Japan for—for $6,000, if you deduct the 22-percent commodity tax, it could actually leave the port in Japan for, what, $4,700? Something of that sort?

Mr. NIELD. I think that would be my guess. I hope you won't hold me to that. There may be factors I am not aware of. Of course, there are the shipping costs, the port expenses, and so forth.

I have just been given a chart which deals with the very question you are raising. I think perhaps it would be appropriate to include it in the record. It is a chart prepared by the Ministry of Industry in Japan.

Chairman **Gibbons**. Without objection, we will put it in the record as soon as you finish using it there.

[The information follows:]

[From Japan Automotive News, April 1982]

Table 11. Retail Selling Price in Japan compared with that in the United States

1. GAO Report for Selected Models (1979 models)

(Unit: US$)

Item		Sub-compact	Small sporty car	Compact size	Percentage[2]
Effective retail in Japan		7,105	8,605	12,065	100%
U.S. effective retail (including options standard in Japan)		4,810	4,915	6,635	59.9%
Breakdown of additional Japanese costs	Ocean freight and insurance	225[4]	175	210	2.3%
	Port handling & make-ready	105	125	125	1.3%
	Japanese commodity tax	700	850	1,200	9.9%
	Net homologation costs (costs for approval)	110	435	535	3.7%
	Dealer incentives	0	500	500	3.3%
	Higher dealer margin	950	1,425	2,100	15.8%
	Other costs & profit (net)	205	180	760	3.8%
Total of additional Japanese costs		2,295	3,690	5,430	40.1%

Note: 1) Based on the report "U.S.-Japan Trade: Issues and Problems", General Accounting Office (GAO), Sept. 21, 1979.

2) The figures showing the part of the price increase accounted for by an item as a percentage represent the average for the three types of car.

3) Prices are calculated on the basis of 200 yen to the dollar.

4) Produced in Europe, hence the higher freight.

2. MITI Paper (1981 model)

Cost Item	Percentage
Retail Price in Japan	100%
Ex-factory price	32.6%
Optional equipment ordered by Japanese dealer	11.1%
Ocean freight	2.6%
Marine insurance	0.3%
Other import costs	0.2%
Japanese commodity tax	11.1%
Costs related to modification for Japanese approval	5.2%
New car preparation, Banking charges, Warehousing, etc.	21.8%
Dealer margin	15.1%

Note: Based on a survey by the Ministry of International Trade and Industry of Japan.

Mr. **Nield**. I haven't had a chance to review it. It is somewhat complicated.

Chairman **Gibbons**. We will put it in the record.

Mr. **Rehm**. It does, Mr. Chairman, purport to give a complete answer to Mr. Pease's question. Namely, it indicates all of the elements that go to the final retail price on a percentage basis, so the dealer markup, for example, is said to be 15.1 percent; new car preparation, banking charges, warehousing, 21.8 percent; and the like.

So you can study it.

Mr. **Pease**. That would be very helpful.

What about the point that is made, again, by my constituents that U.S. dealers of Chevrolets or Chryslers or Fords can also sell Toyotas or Datsuns, whatever, making it a lot easier for Japanese cars to be marketed in areas where there is not already a large volume, but that is not true in Japan, that in Japan, dealerships are exclusive and American or German or other manufacturers do not have access to any existing dealer networks? Is that accurate as far as you know?

Mr. **Nield**. I have been told this is true. I have no personal knowledge of it. I have been told the same thing.

Mr. **Pease**. Those are the only questions I have.

Mr. Bailey——

Mr. **Frenzel**. Wait a minute. Could you ask that question again? I am not sure I understood that.

Mr. **Pease**. The question is whether the difference in dealership practices between the United States and Japan, and what I have been told is that while the U.S. dealers will handle Chevrolets or Fords or Chryslers and can handle a Japanese line or an Italian line or whatever, in Japan that is reportedly not the case; dealerships are exclusive so that a foreign company does not have access to an existing dealer setup, and if it wanted to penetrate the Japanese market, would have to establish its own dealer sales and service apparatus; and the answer is that the gentleman believes that is correct.

Mr. **Frenzel**. I am not sure that it is. Maybe we should get some other testimony on that. I think the trouble is you probably can get dealerships, but they don't sell any of your cars.

Mr. **Nield**. I have no reason to think that is a governmental requirement. It would seem to me that if it is true—and it may well be true—it would be a commercial decision.

Mr. **Pease**. Let me ask one other question. It just occurred to me.

Consumer Reports magazine this spring said that the best American compact—in fact, the only one that it value rated, or whatever it does, is the Chevrolet. It is a small car; it gets good mileage. Consumer Reports seems to think it is reasonably well-built.

Is there any reason why the Chevrolet wouldn't sell in the Japanese market?

Mr. **Nield**. It has the steering wheel on the wrong side.

Mr. **Pease**. Assuming that that could be taken care of.

The basis for my question is we have been told in the past American cars don't sell in Japan because they are big cars, and the Japanese don't want big cars, and there are taxes based on the weight and horsepower; but that would not apply to the Chevrolet.

Is there any reason why the Chevrolet or the Escort, for example, wouldn't be expected to sell well in Japan?

Mr. NIELD. I think probably it would sell well if it could be priced competitively with the Japanese cars that were on sale there already. Volkswagen does market cars in Japan; BMW does, also. The American cars marketed in Japan have been mostly the larger cars, not the smaller cars. They have been more a novelty vehicle or possibly a taxicab or limousine-type vehicle which meets a special need in Japan which they don't adequately manufacture in Japan.

But there really has not been a major effort on the part of U.S. companies to market an appropriate volume car in Japan. Maybe that would be the car that would do it. I don't know.

Mr. PEASE. Thank you very much.

Mr. Bailey has asked me to yield to him for 30 additional seconds.

Mr. BAILEY. You are very, very, very kind. Watch the clock, Mr. Chairman.

Chairman GIBBONS. Five are already gone.

Mr. BAILEY. Your opinions are that countervailing duty remedies are adequate, the law is adequate to the task?

Mr. REHM. Correct.

Mr. BAILEY. Thank you.

Second, Japan's market is as open as ours?

Mr. REHM. No; I wanted to stress, in terms of governmental policy, governmental rules, regulations, yes. In fact, more open. They have zero duty.

Mr. BAILEY. Their market is as open as ours——

Mr. MILLET. Refer that strictly to the automobile industry.

Mr. BAILEY. No; he is widely specialized in that general area.

You made a comment Japan's market is as open as ours. If it is not, it is more because of custom? Cultural differences?

Mr. REHM. In governmental terms, it is as open as ours.

Mr. BAILEY. Third, the reason that American automobiles have not been marketed in Japan has been due to the attitude of our manufacturers?

Mr. REHM. That is my belief, yes.

Mr. BAILEY. Your opinions, even among those who oppose this legislation, are unique. You have more experience with it than I do. Again, I want to thank you in particular.

Mr. NIELD. I don't think Mr. Rehm meant by the attitude of the manufacturers to be uncomplimentary.

Mr. BAILEY. I didn't take it that way. I think they were discouraged. They were going abroad, manufacturing abroad, selling abroad in other areas. But his point is very well taken. I think it is as opposed to seeking some official solution, we are talking about a cultural and custom problem.

I think that is a point to make, a good point.

Thank you.

Chairman GIBBONS. You owe your friend over there, Mr. Pease, 15 seconds.

Mr. BAILEY. The Chairman was jealously guarding your time, Mr. Pease.

I will make it up to him.

Chairman GIBBONS. Thank you, gentlemen.

Our next witnesses are the American International Automobile Dealers Association, Mr. Robert McElwaine, David M. Zinn, and Bart Fisher.

STATEMENTS OF DAVID M. ZINN, CHAIRMAN, AND ROBERT M. McELWAINE, PRESIDENT, AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION, ACCOMPANIED BY BART FISHER, COUNSEL

Mr. ZINN. Good afternoon.

I am David Zinn, chairman of the board of the American International Automobile Dealers Association. I am from Miami, Fla., where, with my sons and nephews, we own and operate five imported automobile dealerships, selling Toyota, Datsun, Mazda, Isuzu, Volvo, and DeLorean automobiles—all imports.

As chairman of AIADA, I represent the interests of 7,000 imported automobile dealers and their 165,000 employees, all of whom depend on the free exchange of goods between nations for their livelihood and the security of their very substantial investments.

Currently, my dealerships employ 275 people with an annual payroll of $6,565,000, all of this from a meager beginning just 16 years ago when I began my great American dream with $7,000 of my own and $15,000 I borrowed and a line of credit provided by a local banker who listened to my plea and had confidence in me and a father who cosigned a blanket guarantee pledging to pay if I did not.

There it all started, my $22,000 in capital, a bank to finance my cars and two employees. I am a man who worked, achieved and lived the dream that makes this country the greatest Nation in the world.

Now, someone wants to turn my dream into a nightmare. Legislation before this committee would reduce the availability of new cars to my dealerships by 60 percent. This would come on top of the imposition of the voluntary restraints of export of Japanese cars by the Japanese Government that has already put severe restriction on my supply and has severely diminished profit.

Two of our 5 dealerships are in the loss column for the 1982 calendar year and the others are not what they should be. When considering that this legislation would cut us back 60 percent, could this same bill legislate a 60-percent reduction in my rent, in my insurance, utility bills, and other fixed expenses?

How about payroll? Should I lay off 60 percent of my employees? And if I did, could my business survive with such a drastic curtailment?

I have no doubt that passage of this legislation would immediately close two of my five dealerships and lay off half of the people in the three I would attempt to keep open. Multiply what will happen to me by the rest of the 7,000 imported car dealerships, and I believe that between 75,000 and 90,000 American workers in these imported dealerships will become unemployed.

I further believe that 2,000 to 2,500 of these dealerships would close permanently, not only creating the loss of the aforementioned jobs, but also wiping out the substantial life savings investments of thousands of small businessmen with one stroke of the legislative pen.

All this at a time when a new record of business failures was set 2 weeks ago, as over 650 businesses closed. During the past 9 months, over 17,500 businesses have closed in this country, a number that is significant because that is more failures than ever before in an entire year, and we still have 3 months left this year.

This legislation will result in the direct loss of thousands of jobs and indirect loss of thousands more. Any consequent return to work by Detroit's UAW workers would not match the number of Americans this bill would put on the streets.

Mr. Fraser has referred to this as a jobs bill, and I believe he may be correct. It would take 85,000 of our American employees and put them out of work to put back a maximum of 46,000 of his people and that is just not right.

The problems of the auto industry cannot be solved by shutting down imports. There will never be a return to the 1940's and 1950's methods of making cars. Some of those unemployed Detroit workers will never work at those jobs again.

That is a fact that must be faced. New ways and methods must be found to promote business-union-government cooperation instead of confrontation. This bill is just not the answer.

This legislation would result in fewer imported cars that would be sold at a higher per unit cost; net effect: The consumer has to pay more. Since our prices would go up, this would trigger an instant raise on the part of the domestic manufacturers, since the stabilizing effect imports have on domestic prices would now be gone.

Result, the consumer must pay more. If the American consumer has to pay more for his automobile, he has less to spend on medical care, movies, eating out, clothing, et cetera.

Harbridge House, a respected research firm, has just completed a study that projects an increase in the average price of a car of $3,200 as a consequence of this measure and the quotas already in place.

There is no justification for spreading the unfortunate plight of the auto workers of Detroit through the rest of the United States and into the houses of the employees in imported car agencies, dock workers, aircraft employees, office equipment employees, electronic equipment workers, et cetera; all of whom would be subjected to retaliatory restrictions abroad. Better management, greater efficiency, increased productivity, lower interest rates and more affordable car prices are the answer, not protectionism.

Thank you.

Chairman GIBBONS. Thank you, Mr. Zinn.

Mr. MCELWAINE. Mr. Chairman, I am Robert McElwaine, president of the American International Automobile Dealers Association. Before I get to the main point of my testimony, I would like to deal with some of the subjects that have been discussed before the committee this morning, and some of the immediately preceding days.

Most of them have to do with the supposed inequality of access to each other's automobile markets between the United States and Japan. I want to support some of the things that were said by the representatives of the manufacturers' groups who preceded me here, because I know Mr. Bailey has not found anybody who has the same feeling about the Japanese market, that from a government standpoint it is more open than the American automobile market, but here is at least the second one.

I have been involved for 14 years in the imported automobile industry. I have had a good chance to look at the situation in Japan. I have been there several times. I have met with the Japanese Government, the manufacturers.

The impression I had is that their market, from a government standpoint, is more open than ours. It is not the Japanese Government that has a 25 percent duty on trucks, which is one of the highest duties anywhere in the world today on any product.

It is the American Government.

The Japanese duty is zero on trucks, automobiles, and automotive parts. In addition to our 25 percent duty on trucks, we have a discriminatory 2.6 percent duty on automobiles which we do not apply to imports from Canada, because they are made by American manufacturers.

On top of that, we have a quota on Japanese automobiles. Call it a voluntary restraint agreement, whatever you will; it is a quota. We imposed it. The Japanese did not.

All of this in contrast to the situation in Japan. In Japan, we also heard much about this inspection thing, that the Japanese require that every car that comes in be inspected. Well, so does the United States unless the car has been manufactured in the home market to U.S. specifications.

There are several thousand cars that come into the United States every year that were not manufactured to U.S. specs. Those cars must be modified by hand individually, inspected by U.S. Government inspectors, and certified.

Mr. Pease was asking about the cost. What does it cost to modify a car in Japan to meet Japanese standards? I am not sure. I know what it costs to modify a car to meet the U.S. standards when it has been brought in in a state where it does not comply.

It can cost between $10 and $15,000 to modify one car. The entire emissions system, safety systems, doorframes, everything else have to be changed.

Consumers are paying this in some cases simply to get a car that is not available through the normal importers. The system and the access, however, is very much the same.

I also heard this morning a statement that non-Japanese imports are down by 25 percent and that the Japanese imports are down by a very slight amount. I don't know what was the source for these.

These are the monthly sales figures which we compile every month, and what they show is that Japanese automobile imports for the year to date, 1982, were down 9.4 percent, almost entirely as a result of the quota arrangement with the Japanese.

Mr. **Bailey**. If the gentleman would yield on that point, that was the testimony this morning. That was the total overall figure. The 9 percent was Japanese. It squares with what you said. The witness didn't contradict with what you said.

Mr. **McElwaine**. But European imports are up, not down. The average for all imports is down only 8.7 percent. So, the non-Japanese imports have actually increased and are taking over some of the market which the Japanese have been forced to forego as a consequence of the quotas.

BMW sales are up 16 percent; Jaguar sales are up 10 percent; Porsche sales up 18 percent; Renault sales up 26 percent; Saab sales up 28 percent. They are filling in the marketplace wherever the Japanese are being kept out.

I think the other point that has been talked about so much that I feel I have to discuss is this matter, which comes up with every witness, of the yen-dollar relationship. Are the Japanese manipulating the yen in order to sell more products abroad?

Well, I have here Value Line, which was published yesterday, which is sort of the bible of the stock market and the stockbrokers and investors.

The dollar's changing fortunes is the subject of their headline article. They show that since December of 1980, the dollar has risen 55 percent against the French franc, 40 percent against the British pound, 28 percent against the German deutschmark, and 27 percent against the Japanese yen.

Now, what the question is here is have we raised the bridge or lowered the river? Is the yen really undervalued in terms of the dollar or is the dollar simply overvalued in terms of every other currency in the world?

It seems to me the latter, in looking at these figures, is a much more reasonable assumption. Having an undervalued yen is not all that much of an advantage to the Japanese. The Japanese Central Bank has lost billions of dollars in the last few months trying to prop up the yen, intervening in the currency markets to prop it up.

Having that continuous outflow of currency from the yen into the dollar from Japan to the United States poses serious economic and inflationary problems for the Japanese, and they are not all that happy about it whatsoever.

I would like to really congratulate this committee, though, for shedding more light in the past week on this bill than it has seen since it was first introduced more than a year ago.

I am certainly not going to sit here and try to belabor you by repeating things you have heard from previous witnesses. You have heard a great deal of information. I simply would like to try to pick out some points which I think might shed some new light on this situation.

I have listened to much of the testimony given so far, and I have read what I haven't heard. At this point, I am still waiting for some witness to come before you and talk about economies of scale, because economies of scale are what this bill is all about.

In fact, economies of scale are what the automobile industry is all about today. I am very puzzled by the kind of reluctance of the proponents of this bill and the supposedly neutral domestic manufacturers to discuss what is really the central issue of this legislation.

There seems, instead, to be a very strong desire to have this committee focus on import competition and these cars from Japan as the real source of Detroit's problem; but let's look at the other side, at economies of scale.

Today, aside from a couple of very high-profit, low-volume cars like the BMW and the Mercedes, the whole industry is struggling to achieve economies of scale.

The economies that you gain from volume are a company's true measure of productivity, labor cost, and of profitability.

We have seen Volkswagen of America in very serious difficulties today, losing money at a perilous rate. The president of the company, a good friend of mine, Jim McLarnen, resigned yesterday over this situation. Their whole cost, their whole problem has been that they have not been able to achieve economies of scale in their American operation that would permit it to be successful.

Because one of the basics of automobile production is that the more volume you produce of any model or any particular unit or component of that model, the cheaper it is to produce.

A model produced in a volume of a million or more units can cost as much as two-thirds to one-half less than the same model produced in volumes of, say, 200,000.

This is the complete and very simple explanation for this rash of joint ventures, cross-sourcing, foreign-sourcing, and mergers, that have been going on in the automobile industry for the last couple of years.

Simply because it is a lot more economical to buy 200,000 small cars from Isuzu or Toyota or somebody else than it is to set up a factory and build 200,000 small cars, because those companies you are buying them from are building those cars in quantities of millions.

They can turn out an individual unit for two-thirds less than you can make it if you are only going to make 200,000.

It is the same way with the engines. The break-even point on an engine plant is 400,000 units. How are you going to sell 100,000 units of an automobile if you have to set up an engine factory and make 100,000 engines to fit that automobile? You are going to go broke very quickly.

In the decades from, say, 1950 to 1979, the American automobile companies were able to achieve a level of profitability that enabled them to pay one automobile executive $1.2 million a year; that enabled them to pay dividends to their shareholders that were all out of line with the size of the companies and their profits, but made their stock very valuable and very effective.

In one year when the Ford Motor Co. lost money, it paid $34 million in dividends to the Ford family alone.

They were able to sign wage contracts with the United Auto Workers that made the UAW workers among the highest paid workers in the world; and more important, they were able to engage in a sort of corporate adventurism that saw billions of dollars flow from the United States into foreign factories owned by these companies. They were able to do so because they achieved economies of scale on a level that nobody had ever achieved before in any industry.

For decades, they made essentially the same car. They made a heavy, steel-framed, V-8 engine, rear-wheel-drive car, and they enjoyed interchangeability of parts and production of up to 10 million units a year.

These models were so similar that it only cost a few hundred dollars more to produce a Cadillac than it did a Chevrolet, and the Cadillac sold for $3,000 to $4,000 more than the Chevrolet.

It was a time of immense profits because of economies of scale. Suddenly, we had the OPEC revolution. All these economies of scale vanished, because they suddenly had to go back, completely make over their entire model line, and start making low-volume production of a lot of different cars, especially in the small-car field.

Suddenly, the Japanese had the advantage of economies of scale, because since the inception of the Japanese automobile industry, they followed one philosophy, which is, you build everything in one place; you build all your cars in Japan and you export up to 40 percent of what you produce, and you wind up with economies of scale that absolutely buffaloed the American manufacturers and gave the Japanese advantages in pricing.

It isn't lower labor costs, it isn't even the yen-dollar relationship, although that has at least a temporary effect. It isn't inventory controls or better management, any of these other things that has really given the Japanese the cost advantage.

It is economies of scale. They are producing millions of units of small cars that have brought their costs down so far that the American manufacturers have not been able to catch up.

It is the necessity to overcome this advantage that forced the American manufacturers into their world car concept. They decided, we built these factories all over the world; we have got factories in Spain, in France, in Taiwan, in Korea, in Germany, in England; we have factories in Brazil, Argentina, everywhere; what we will do is make huge volumes of components and units in those individual factories where we can achieve economies of scale on the components and then assemble the components in the market country where we are selling the car.

That is how we are going to match them. It is this concept that is the target of the United Auto Workers and the domestic content law, not the importers or the imported automobile.

I think the proponents of the bill have been very clever in convincing the public that their real targets are those nasty Japanese cars, because there is an emotional climate in this country that they can take advantage of and you have a bill that will make jobs, cut down on those nasty Japanese cars, and they have a lot of support for it.

They got 230 Congressmen to sponsor the bill; but imports are merely, as we used to call them, in the Navy, targets of opportunity. The primary target of this raid is Detroit's world car policy; and if they succeed in getting this bill passed, Detroit manufacturers will not be able to achieve the economies of scale that they must achieve if they are going to be competitive with the Japanese in the world market.

Surely, Ford, and General Motors are aware of this. Why have they not brought this out in their testimony before this committee? Maybe they are just reluctant to discuss their global production strategies, because they would be criticized for exporting American employment abroad. I don't know. I don't know their reasoning on this.

I suspect that that may be their reason; but the fact is that in light of this vast foreign expansion of Ford and General Motors during the last 40 years, they have no other strategy that will enable them to remain viable and competitive in the world automobile markets in the eighties and nineties.

When you look at it in this light, the Ottinger substitute for the original domestic content bill manages to give us the worst of two worlds. It has taken what was a simplistic bad idea, and turned it into a complex bad idea. It remains bad law and worse economics.

The way it is drafted now, it would have its most adverse impact on our domestic manufacturers as well as on those foreign manufacturers who have committed themselves to production in the United States; and the latter list includes, in addition to Volkswagen, Honda, and Nissan, now Toyota, because Toyota has concluded nearly every detail of its agreement to produce automobiles for distribution by General Motors, except perhaps the formal announcement to the press, which I expect sometime this month.

But by robbing these foreign companies of flexibility in their model mix and their sourcing options and in the capacity to respond to changes in the marketplace, as well as changes in exchange rates, changes in the economy, H.R. 5133 would almost guarantee the failure of these kinds of American ventures.

Last week, I sat here with you and I listened to the very eloquent testimony of Phil Hutchinson, speaking from Volkswagen of America. He talked about, in passing at least, the terrible threat to the hundreds of millions, now billions of dollars, really, in foreign investment that have already been made by overseas automobile manufacturers, a threat that is posed by domestic content legislation.

Phil's statement, as I remember, was that H.R. 5133 will jeopardize Volkswagen of America's U.S. operations. He didn't elucidate on that. He let it go at that blunt statement, but it is obvious, looking at Volkswagen today, that the reason it would do so is the matter of economies of scale.

Volksagen's American plant was established on the basis that it would break even at about 215,000 units a year. They thought in terms of a 500,000-unit annual sales level at which point they would become quite profitable. Well, they have never made the breakeven point.

At the present time, they are selling about 150,000 cars a year out of their Pennsylvania factory.

Some statements place their losses as high as $600 a car. They manage to offset their losses somewhat by the profits they are making on 100,000 imports a year that they bring in, because these are high-priced, high-profit cars. They are doing well on those.

But if its U.S. sales, its Pennsylvania plant sales, do not improve in the near future, the only answer for Volkswagen might well be to reduce their dependence on American components and parts, which they are building at such low volume that they are losing money on them, and begin to import those components from Germany, where they are building them at very high volume, and they are very cheap.

Under H.R. 5133, they would not have that option. That would be closed to them. So they would have to decide on something else.

What is the something else? The something else is that you close down your Pennsylvania plant and you become a pure importer again, and you give up selling cars that you lose $600 apiece on, you sell cars that you are only making $2,000 apiece on.

I am not chairman of the board of Volkswagen. At this point in history, I say thank God. But that would be a fairly easy decision to make if I was in that position, I think.

Nissan has already indicated that domestic content legislation would force them to rethink their commitment to a $300 million investment in the Tennessee light truck factory. You can't really guess what the impact would be on Toyota and General Motors' joint venture, but obviously, if General Motors were forced to comply with a 90-percent domestic content law, and the Toyota deal would bring their content below that level, the deal would not go through.

Meanwhile, under some interpretations of the present substitute on the energy bill, almost any importer, through some kind of creative bookkeeping, could achieve a 25-percent domestic content level.

That would enable him to sell 250,000 cars a year in the United States. This would be very bad for Toyota and Nissan, one of whom sells 500,000 cars, the other sells 700,000 cars, but it could very well result in absolutely no decrease in imports at all as firms like Isuzu, Mitsubishi, Subaru, Fiat, Renault, and so forth, filled in the hole in the market that would be left by the cutoff of Toyota and Nissan cars.

What we look at is a bill that could, one, make the U.S. automobile industry permanently noncompetitive by closing off its only available option to achieve economies of scale comparable to those of the Japanese; two, cutting imported cars back by close to a million units; and, three, it could well foreclose the very promising development of foreign production capacity in the United States.

Here we have to go back to economies of scale again because of all the imported cars sold in the United States, 85 percent of them are sold at levels that would not justify U.S. production. There is only one foreign car sold in the United States that is sold at sufficient volume that production in the United States would be even remotely practical, and that is the Toyota Corolla.

They sell about 135,000 of those. No other model is sold in sufficient quantity to justify American production. So to assume that this bill is going to result in foreign companies rushing to build plants here to turn out cars below practical levels of scale is simply unreasonable.

Even the Corolla could only be sold here if Toyota could realize economies of scale by bringing in most of the major components from Japan. Certainly if they had to achieve a 70-percent domestic component level, the factory would be neither reasonable nor practical.

Watching the experience of Volkswagen of America, which came into this market committed to a very high level of U.S. content, and they achieved a 70-percent level in their American-built cars, watching their experience and the terrible losses they are suffering, has made every manufacturer in the world all too aware of the financial pitfalls that you are looking at when you talk about a commitment to U.S. production at a high level of domestic content and a low volume.

It is a recipe for economic suicide.

I just want to talk one second on the subject of consumer costs, because I heard the statement made in this room that passage of the domestic content bill wasn't going to raise prices for consumers in the automobile field.

I even heard the statement made that the existing voluntary restraint agreement had not raised prices. I don't know the source of these statements, but they are so at variance with the facts that I find them astonishing.

We got curious. We said, sure, how much impact has this quota had on car prices? So we have got a lot of data that we keep; all kinds of data, statistics; I have a computer that is busy all day long. We didn't try to figure it out ourselves.

We went to a very respected research firm, Harbridge House, up in Boston. We said, What has the impact been on the consumer of the Japanese quotas? They came back in about 6 weeks with this booklet. It says the quotas on the part of the Japanese have cost the consumer $1,900 for each car that is imported from Japan; $700 of that is due to change in the model mix; and yet, we heard statements made there has been no change in the model mix.

Here are our statistics, out of our computer: Japanese car sales in the 12 months up to June of this year were down about 175,000 units from the previous year; their value was up a half a billion dollars, so they reduced their sales by 175,000 units and took home an extra $500 million from us.

Chairman GIBBONS. Could we put that in the record now?

Mr. McELWAINE. I would be delighted to.

[The information follows:]

Statistical information

Projected import sales for 1982	2,200,000
Import sales in 1978	2,000,000
Import sales in 1977	2,100,000
Import sales in 1979	2,300,000
Japan imports, 12 months to July 31, 1982	1,785,572
Japan imports, 12 months to July 31, 1981	1,983,769
Change	198,197
YTD Japanese sales by model:	
Toyota:	
Corolla, 1982	122,241
Corolla, 1981	189,207
Change (−35 percent)	66,966
Cressida, 1982	24,344
Cressida, 1981	20,464
Change (+19 percent)	3,880
Supra, 1982	22,470
Supra, 1981	9,716
Change (+131 percent)	12,754
Celica, 1982	82,694

YTD Japanese sales by model—Continued	
Toyota—Continued	
Celica, 1981	73,561
Change (+12.4 percent)	9,135
Honda:	
Civic, 1982	89,992
Civic, 1981	112,232
Change (−20 percent)	22,240
Accord, 1982	133,743
Accord, 1981	123,742
Change (+8 percent)	10,001
Value of Japan imports, 12 months to May 31, 1982	$9,433,309,000
Value of Japan imports, 12 months to May 31, 1981	$8,938,754,000
Change (up)	$494,555,000

Mr. McElwaine. Toyota's cheapest model is the Corolla. So far in 1982, they have sold 122,000 of them in the United States. Last year, at this point, they sold 190,000. The cheaper model is down by 67,000 units.

Their most expensive model is the Cressida. Cressida sales are up 19 percent. The next most expensive model is the Supra; sales are up 131 percent. Next is the Celica. Celica sales are up 12.4 percent.

Honda makes two models. The cheap model is the Civic; so far for 1982, Civic sales are down 20 percent, 22,000 units. The most expensive model is the Accord; so far, its sales are up 10,000 units or 8 percent.

It just seems very clear to me on the statistical face of it, that the quota has simply resulted in upgrading of the model mix by the Japanese; they are taking more money out of the American market than they took before the quota went into effect; and the consumer is paying for it.

Chairman Gibbons. Exactly what I am predicting and I am sure other people predicted it.

Mr. McElwaine. I remember you saying it when we testified before your committee more than a year ago, 2 years ago.

We also asked Harbridge House on the basis of those findings, how big an impact will domestic content law have on the consumer? They came back a couple of weeks later and said, it will run that increase up to $3,200 a crack.

Their study is not based on economists' projections or econometric models. It is based on the real world. They just took what has happened and projected it into the next step.

I think that is maybe one of the problems that we have had with this particular bill, that we have been dealing almost all the time with econometric models, economists' projections, and we haven't looked at the real world.

We get projections that say this bill will create 1 million new jobs. We go out and look at the real world and say, well, say it will cut back imports 1 million units; say it will increase domestic car sales by 1 million car sales; what will it do for jobs?

You don't have to ask an economist. We have increased car sales from one year to the next by 1 million units a dozen times in the history of the automobile industry. The Bureau of Labor Statistics keeps all the figures. How many new jobs did that create when it happened? We went and looked at it.

Over 15 years, every time you increased automobile sales by 1 million units, you created 33,000 incremental jobs. That includes manufacturing, supplies, and retailing. Not 1 million, not 900,000, not 865,000, but 33,000.

Well, if you provide 33,000 jobs, you close 2,000 car dealerships where you have an average of 33 car dealers apiece; you have lost 66,000 jobs, you have lost more jobs than you have gained.

I read a book recently called "The Imperious Economy." It was written by an economist named David Galleo. I think it is a significant book. He calls ours the age of economic gimcrackery, where policy has been a restless search for magic tricks and formulas.

In H.R. 5133, I think we perceive evidence of this desire to find some kind of quick fix that will undo decades of neglect in capital investment requirements, years of lavish squandering of profits, and a history of foreign adventurism into alluring foreign ventures at the expense of domestic decline.

This is an age of gimmickry. We have seen people who have abused their bodies and neglected their health, permitted their lives to degenerate and decay and who are unwilling to face the difficult regimen of proper diet, physical fitness, reorganizing their lives; instead, they take a pill, they feel better.

Well, I think domestic content is a legislative pill. It may give somebody a temporary feeling of well-being, but it is going to solve none of the basic problems of the automobile industry and indeed, it will exacerbate most of them.

There is no quick fix for Detroit. There is only the long, hard struggle for them to regain their competitive position. They have come a long way. They have improved their product, they have improved their quality, they have reduced their bloated costs to a point where domestic manufacturers have been able to show a profit this past year in the face of the worst slump in the market in 20 years; but they still have a long way to go.

I think the Government can help them. But certainly not by legislative happy pills such as H.R. 5133. It is going to take the dull, difficult, and not very publicity-creative work of tax reform that will help the manufacturers acquire needed capital through such means as we discussed at our last hearing, Mr. Chairman, permitting the manufacturers to return to this country some of the billions that they hold overseas without necessarily penalizing them with U.S. income taxes. Government can help by the tedious and difficult and sometimes frustrating work of negotiating new international agreements governing performance requirements and investment incentives.

These are the kinds of hard, difficult choices we face. I think Government can only delay or perhaps permanently forestall the recovery of the domestic automobile industry by acting as sort of a legislative Dr. Feelgood through such gimcrackery as domestic content laws.

We would like to appeal to this committee and to this Congress to give serious study to this kind of difficult, long-term reform that we need to restore our automobile industry and to reject these kinds of quick fix gimmicks like H.R. 5133.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Mr. McElwaine. That is an excellent statement, eloquently delivered.

Without objection, we will put your full statement in the record in case you missed any of it. I don't think you did. Without objection, we will put the Harbridge study in the record.

[The prepared statement and study referred to follows:]

STATEMENT OF ROBERT M. MCELWAINE, PRESIDENT, AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION

No American business group is more concerned with the legislation requiring domestic content in automobiles sold in the United States than the 7,000 businessmen who sell and service imported automobiles and their 165,000 employees. Independent studies have predicted that passage of H.R. 5133 would close 2,000 of these small businesses and idle from 65,000 to 90,000 of their employees.

Quite naturally, the dealers feel they are being asked to sacrifice their businesses and their employees' jobs in order to protect the jobs of one of the highest paid segments of American labor. They are understandably resentful and angry, as I am sure many of this committee have learned from their constituents.

We congratulate the committee for shedding more light on this measure than has been given it in the entire year since its introduction. It is not our intention to belabor this committee with information or statements you already have heard from other witnesses in the week of hearings. Rather, we would like to offer the committee information and views that would provide fresh insight on our industry and the effect this ill-advised legislation would have on it.

I have listened to much of the testimony before this committee and I have read what I have not heard. I am still waiting for a witness to discuss the issue of economies of scale. Economies of scale are what H.R. 5133 is all about; indeed, it is what the whole automobile industry is about today. I am puzzled by the seeming desire of the proponents of this bill and the supposedly neutral domestic industry to focus on other, more peripheral matters. There seems to be a reluctance to discuss the central issue of this legislation and a desire to have the committee focus on import competition as the source of Detroit's problems.

Today, aside from some few high-profit, specialized manufacturers such as Mercedes-Benz and BMW, each mass market manufacturer is concentrating on achieving economies of scale. Such economies are the true measure of productivity, of labor cost—and of profitability.

One of the basics of automobile production is that the more volume you produce of a given model or component, the less it costs to produce. A model produced in a volume of a million or more units may cost only two-thirds as much per unit as the same model produced in a volume of a few hundred thousand. That is the complete and simple explanation for the rash of joint ventures, cross-sourcing and foreign sourcing that have been the most significant developments in the automobile industry in recent years.

It is far more economical to purchase 200,000 small cars from a firm producing a million of the same model than it is to establish a factory to produce 200,000 similar cars. It is far cheaper to buy a half-million engines from a firm manufacturing two million of them than it is to produce a half-million at your own plant.

In the decades from 1950 to 1979, American manufacturers achieved a level of profitability that enabled them to pay as much as $1.2 million a year to a single executive; to enter into labor contracts that made their workers among the world's highest paid; to issue dividends to their shareholders that made their stocks both coveted and expensive. They managed this envied level of profitability by achieving economies of scale unmatched and unprecedented in the automobile industry.

Producing up to ten million vehicles annually for the world's largest car market, they concentrated their production on vehicles of remarkable similarity—heavy, steel-framed cars with V-8 engines and rear-wheel drive. They enjoyed interchangeability of parts and components and were so similar in design that a Cadillac cost only a few hundred more dollars to produce than a Chevrolet, yet sold for thousands more.

These economies of scale vanished in the aftermath of the OPEC revolution. Forced to re-build their entire model fleet to meet new demands for fuel efficiency, domestic manufacturers lost their advantages of scale. This loss has been further exacerbated by a decline in U.S. sales of nearly four million units since 1978's peak year.

Now it is the Japanese who enjoy the advantages of economies of scale. By concentrating their productive facilities in their home country and exporting up to forty percent of the finished product, the Japanese have achieved economies of scale that give them a competitive advantage over the American firms that have, as a policy, scattered their production centers over the face of the globe.

It is economies of scale, not lower labor costs, inventory controls or better management that have given the Japanese manufacturers the cost edge over Detroit. Labor costs, after all, are measured with a highly elastic ruler—the currency exchange rate. The Japanese labor cost is generally measured at $12 an hour, compared to more that $20 an hour for domestic labor costs. That ratio, however, is at 260 yen to the dollar. At a more reasonable and realistic 180 yen to the dollar, the Japanese worker's cost goes up to $17 an hour. That's hardly slave wages and would make the labor cost differential between Japanese and American cars negligible.

Changes in the exchange rate will not affect the economies the Japanese have achieved through concentrated volume production. It is this advantage that concerns the American manufacturers far more than labor costs, inventory controls or quality circles. The growing necessity of overcoming this volume advantage led the American producers to the "world car" concept. By producing major components at sufficient volume to supply global needs at individual factories scattered throughout the world, then assembling them into finished product in the market country, they calculated to match the Japanese in volume efficiency and economies of scale.

It is this concept that is the principal target of the United Auto Workers and the domestic content legislation before this committee. Proponents of the bill have cleverly taken advantage of the current emotional climate concerning Japanese auto imports to mask the true purpose of the bill. Imported automobiles are merely targets of opportunity in this campaign—it is Detroit's world car concept that is the main objective.

Surely, Ford and General Motors are aware of this. Why, then, have they not brought this out in their testimony before this committee? Perhaps they are reluctant to discuss their global production strategies for fear of being criticized for exporting employment. The fact is, however, that in light of the vast foreign expansion of Ford and GM in previous decades, there is no other strategy that will enable them to remain viable and competitive in the world automotive markets of the eighties and the nineties.

Seen in this light, the Ottinger substitute, the bill now before this committee, has provided us with the worst of two worlds. It has turned to simplistic bad idea into a complex bad idea. It remains bad law and worse economics. As drafted, it would have its most adverse impact on our domestic manufacturers and those foreign manufacturers that are committed to production in the United States. This list includes, in addition to Volkswagen, Honda and Nissan, Toyota which has concluded nearly every detail of its arrangement to produce automobiles in America for distribution by General Motors except the formal announcement to the press.

By robbing these foreign companies of flexibility in model mix, in sourcing options and in the capacity to respond to changes in the marketplace, the exchange rate and the economy, H.R. 5133 would virtually assure the failure of their United States ventures.

We all heard the eloquent testimony last week of Mr. Phil Hutchinson from Volkswagen of America. He alluded only in passing to the terrible threat to the hundreds of millions in foreign investment already made by overseas auto manufacturers that is posed by domestic content legislation. H.R. 5133, said Mr. Hutchinson, will jeopardize Volkswagen of America's U.S. operations. He did not elucidate, but the reasons are apparent.

The reason again, is economies of scale. Volkswagen's American plant was established on the basis that it could break even at a volume of a little more than 200,000 units. When Volkswagen reached its U.S. goal of 500,000 units, the planners envisioned that economies of scale would make the venture highly profitable.

Unfortunately, Volkswagen has never even reached the breakeven state. Today, they are losing massively on their U.S. operation. Some estimates place their losses as high as $600 per car. These losses are somewhat offset by their imports, which are highly profitable. If its U.S. sales do not improve in the near future, Volkswagen might, conceivably, move to cut its production costs by importing more components from Germany, where they are made at a volume level that reduces their price.

Under H.R. 5133, however, Volkswagen would be denied this flexibility. In that case, they would have two choices—continuing to lose massive amounts of money through their American production or dropping their U.S. operations and becoming once more a pure importer. Since the latter course would enable them to sell only cars that are highly profitable, this decision would seem a simple one to make.

Nissan has already indicated that domestic content legislation would make them re-think their commitment to a $300 million investment in a Tennessee light truck factory. The impact of the bill on General Motors' venture with Toyota cannot be estimated accurately, but it would seem obvious that if the Toyota deal brought GM's domestic content below 90 percent, the factory would never by opened under H.R. 5133.

Meanwhile, however, under some interpretations of the substitute bill, almost any importer might achieve a domestic content level of as high as twenty or twenty-five percent, without any real change in manufacturing procedures or sourcing. This, of course, would hit very hard at Nissan and Toyota, but it could very well result in no reduction in imports at all, as Isuzu, Suzuki, Mitsubishi, Subaru, Mazda, Fiat, Renault, et al., rushed to fill the hole in the U.S. market.

Consequently, the results of H.R. 5133 would be (1) to make the United States automobile industry permanently non-competitive by closing its only available option to achieve economies of scale comparable to those of the Japanese; (2) it would reduce imports from Toyota and Nissan by one-half to two-thirds; and (3) it might well foreclose the promising development of foreign production capacity in the United States.

Here we return to the theme of this testimony—economies of scale. Fully 85 percent of imported car sales in the United States is represented by models whose annual sales volume is far below the minimum required to make U.S. production profitable, practical or feasible. Of all the imported cars sold in this country, only the Toyota Corolla is sold in sufficient volume to make U.S. production appear even marginally practical.

Even the Corolla could be produced profitably only if the manufacturer were able to take advantage of the economies of scale inherent in the volume production of major components in Japan. Under no circumstances could U.S. production be profitable at the 70 percent domestic content level that would be mandated by H.R. 5133. The Volkswagen experience has made every world manufacturer all too aware of the financial pitfalls that accompany a commitment to U.S. production with a high level of domestic content.

There are some things claimed for the bill that it certainly won't do. It will not result in any substantial re-employment of the idled automobile workers. And that is the real tragedy of this issue. Proponents of the bill have held out to the unemployed workers of the U.S. auto industry the hope that their desperation can be ended by a simply legislative fiat called domestic content. The anger and frustration of these workers when their hopes are dashed, as they inveitably must be if this bill is passed, can only be imagined.

One of the many negative effects of H.R. 5133 would be the substantial increase in consumer prices it would bring about. I have sat in this hearing room and listened to gentlemen from Detroit say that the bill will not materially increase prices. I have even heard them claim the existing Japanese automotive quota has not raised prices or changed the model mix of the imports.

I find these statements astonishing, they are so at variance with the facts. When we at AIADA became curious about the consumer effects of the Japanese quota, we did not even attempt to draw conclusions from our own statistical data bank. Instead we went to an independent source—the respected, Boston-based research firm of Harbridge House. We asked them one question: "What effect has the Japanese voluntary restraint agreement on automobiles had on the consumer?"

They returned to us several weeks later with their findings: Japanese quotas had raised the prices of Japanese imports by $1,900 per unit. Further, they said, more than $700 of this increase is due to change in the model mix. We found that Japanese auto imports had been reduced by 140,000 units annually by the quotas—but that imports of luxury models had doubled and tripled. The entire burden of the quotas had been placed on the lowest priced cars in the manufacturer's line.

These are not guesses or estimates. They are facts, printed in Automotive News and Ward's. The U.S. Department of Commerce shows that although the volume of Japanese auto imports declined in the last year by 140,000 units, the dollar value increased by more than a billion dollars. I wonder what sources Mr. Fraser and Mr. Caldwell had for their statements that the quotas had not increased prices or changed the model mix?

We found the Harbridge House study so informative, we asked them another question. "On the basis of your findings concerning the Japanese quota, what would be the consumer effect of the domestic content bill?" They studied that one and came back to us with the projection that H.R. 5133 would jump the price increase on Japanese cars to $3,200 a unit. Furthermore, they concluded, the tendency of domestic manufacturers to follow suit whenever Japanese companies raised their prices was so well established they assumed that domestic car prices would escalate right along with the imports.

The Harbridge House study was unique among the various economic studies that have been conducted on domestic content requirements in that it relied for its findings not on econometric models or economists' projections, but on real life experience. I feel this illustrates one of the chief difficulties with the debate that has been conducted over this legislation. It has largely ignored the real world in favor of the theoretical and hypothetical world of economists.

The United Auto Workers claim the measure would increase U.S. employment by more than a million jobs. Real-world experience does not bear out their hallucinatory projections. We calculate the bill would reduce import sales by as much as a million units a year. Assuming a one-for-one transfer of the embargoed imports to domestic car sales, this would presume a matching increase in domestic car sales. One doesn't need to ask economists what that would mean in terms of jobs. Over the past 15 years, we have had many examples of year-to-year increases in domestic car sales of one million units or more. The Bureau of Labor Statistics has the records of how many new jobs have resulted from such an increase. These records show that, over the years, a one million unit increase in Detroit sales has created, on an average, 33,000 incremental jobs in manufacturing, supplies and retail operations combined. Not a million; not nine hundred thousand; not even 868,000 as the UAW hypothesized initially; but 33,000 jobs.

At the same time, the loss of 40 percent of our imported car sales would close at least 2,000 of our 7,000 dealerships. We average 33 workers per dealership, so that's 66,000 American jobs lost right there.

The UAW claims that passage of H.R. 5133 would result in every major importer building handsome new factories in the United States and employing an astronomical number of workers. But in the real world, domestic content requirements discourage investment.

In the real world, Nissan planned a $500 million factory in Great Britain, to provide jobs for 5,000 British auto workers. but the Common Market refused to grant the product of the factory duty-free treatment under EEC tariff agreements unless the finished product contained 60 to 80 percent British domestic content. The factory has been placed in limbo and will not be built unless this requirement is dropped.

The UAW claims that under a domestic content law, we would have a prosperous, thriving automobile industry, once more working at capacity to bring consumers new automobiles at competitive prices. But we don't have to accept their optimistic projections. We have the real world to study—a world where at least four nations have established domestic content requirements for automobiles. They have such laws in Argentina, Mexico, Australia and Spain. The results indicate that, if you admire the Mexican or Argentine economy, you'll love domestic content laws.

All four of the automotive manufacturers operating in Argentina are losing money and in serious financial difficulties. Cars produced in that country cost from 30 to 50 percent more than the same models produced elsewhere. The same is true of Australia, where the domestic content requirement has added $3,000 to the cost of each vehicle produced. Everywhere domestic content laws have been tried, they have proved a failure.

Witnesses before this committee have claimed that there can be no retaliation by other nations against the domestic content law, because there has been no retaliation against similar laws in Spain, Mexico, Argentina and Australia. Such claims ignore the relative importance of these markets to the manufacturing countries. The state of California alone buys more imported automobiles than all four of these nations combined. One must assume the Japanese would retaliate strongly against the substantial curtailment of their principal export market.

We cannot ignore the fact that, as the world's largest exporter, we are most exposed to trade retaliation. We export 65 percent more than does Japan; we are, therefore, 65 percent more vulnerable to trade action than even that export-conscious nation.

In his thoughtful new book "The Imperious Economy," economist David Galleo has called this the "age of economic gimcrackery" where "policy has been a restless search for magic tricks and formulas." In H.R. 5133, we again see evidence of this desire to find some quick fix that will undo decades of neglect of capital investment requirements, years of lavish squandering of profits and a history of corporate adventurism into alluring foreign ventures at the expense of domestic decline.

We live in an age of gimmickry. People who have abused their bodies, neglected their health and permitted their lives to degenerate into chaos are unwilling to face the difficult regimen of proper diet, physical fitness and organizing their lives. Instead, they take a pill, to feel better.

Domestic content is just such a legislative pill. It may cause a temporary feeling of well-being, but it will solve none of the basic problems of the automobile industry and, indeed, will exacerbate many of them. There is no quick fix for Detroit; there is only the long, hard struggle to regain their competitive position.

They have come a long way since 1978. They have improved their product and their quality; they have reduced their bloated costs to a point where domestic manufacturers have become profitable even in the most depressed market in twenty years. They still have a long way to go.

Government can help them—not by legislative happy pills such as H.R. 5133, but by the dull and difficult work of tax reform that will help the manufacturers acquire needed capital, through such means as returning to this country some of the billions in profits they now hold overseas. Government can help by the tedious and difficult work of negotiating new international agreements governing performance requirements and investment incentives.

These are the hard, difficult choices we face. Government can only delay or perhaps permanently forestall the recovery of the domestic automobile industry by acting as a legislative Dr. Feelgood through such gimcrackery as domestic content laws.

We appeal to this committee and this Congress to give serious study to the difficult, long-term reforms needed to restore our automotive industry and to reject such quick-fix gimmicks as H.R. 5133.

DOMESTIC CONTENT LEGISLATION:
A TAX ON THE AMERICAN AUTOMOBILE CONSUMER

A Study Prepared by
HARBRIDGE HOUSE, INC.
July, 1982

American International Automobile
Dealers Association
1220 19th Street, N.W.
Washington, D.C. 20036
Telephone (202) 659-2561

EXECUTIVE SUMMARY

Proposed automotive domestic content legislation seeks to induce the leading Japanese firms currently exporting passenger cars to the United States to manufacture those cars in this country. If they choose not to do so – out of concerns of cost, economies of scale, and/or loss of quality – the proposed legislation would then impose import quotas on these vehicles.

We have explored the cost of such quotas to American consumers who, based on widely published information about the comparative value of Japanese cars and their personal experience as owners of such vehicles, believe them to be superior to domestically manufactured counterparts. We believe that the best real-world gauge is the effect on the consumer of the first 12 months of the current voluntary export restraints established by the Ministry of International Trade and Industry, even though these restraints reduce the availability of Japanese cars by only about 7 percent as compared with a probable 40 percent cutback that could result from domestic content legislation.

The surcharge paid by American buyers of Japanese cars during the first 12 months of the voluntary export restraints is approximately $1,900 per car. This amount is a combination of three factors: (i) U.S. prices raised to a greater degree than prices of Japanese cars in the Japanese domestic market; (ii) no pass-through to the U.S. consumer of substantial gains from a weakening of the yen against the dollar; and (iii) an upscaling by the Japanese automakers of the mix of cars offered in the U.S. market, a movement away from their lowest priced model series toward their higher priced series.

We believe that a cutback in the availability of Japanese passenger cars of the order of 40 percent – as could readily occur under the proposed local content legislation – would produce a consumer surcharge of at least $3,200 for every American consumer electing to purchase a Japanese car. It would also impose a surcharge on the buyers of domestic subcompact cars because of the demonstrated readiness of domestic manufacturers to raise their own prices sharply under the umbrella of price increases by their Japanese competitors, seeking to improve the profitability of these vehicles rather than attempting to capture a larger market share by underpricing their competitors.

CHAPTER 1
INTRODUCTION

At present, the U.S. Congress is weighing passenger car domestic content proposals that would oblige any manufacturer selling between 200,000 and 500,000 vehicles per year in the United States to maintain a minimum of 75 percent domestic content, with a 90 percent minimum applied to manufacturers selling in excess of 500,000.

If current exporters of automobiles whose sales volumes fall into these categories continue to find U.S. production disadvantageous to their interests for any combination of reasons – inability to achieve adequate economies of scale, concern about level of U.S. production costs, fear that current quality levels cannot be maintained – a domestic content law will simply become an import quota. If it does, what will be the effect, if any, on the American consumer?

In attempting to respond to this question, real-world empirical evidence is more reliable than theoretical analysis. The closest real-world approximation of the effect of the sort of quota-imposed scarcity of imported vehicles that might result from a domestic content law presents itself in the first 12 months of the current voluntary export restraints on Japanese passenger cars announced by the Ministry of International Trade and Industry (MITI) in May 1981. The cutback in the availability of Japanese passenger cars resulting from these restraints – about 7 percent – is much less than the scarcity that could result from a domestic content law. Thus, the impact, if any, on the U.S. consumer of the current reduction in the availability of Japanese passenger cars is logically likely to be less extreme than a measure that could reduce their availability by more than 40 percent.

The purpose of this study is to use simple, conservative, plausible, and empirical means to identify possible ways in which the MITI-imposed cutbacks might affect consumer interests; to investigate each of these; to determine whether the evidence suggests that any substantial effect has occurred; and, where such an effect might appear, to attempt to quantify it.

CHAPTER 2
CONSUMER ATTITUDES AND BEHAVIOR IN EARLY 1979

In 1978, dealer sales of new cars in the United States had reached 11.3 million units, missing the record established in 1973 by only about 100,000 units. The sale of large cars – intermediate and full size – accounted for 50.6 percent of the total market. Imports accounted for 17.6 percent of sales, down from 18.5 percent in 1977. The share of the market held by Japanese cars also declined.[1]

In the spring of 1979, political events in Iran caused a temporary worldwide shortage of crude oil. Motor fuel prices advanced significantly in the United States for the second time in five years, on this occasion by 86 percent,[2] radically changing the behavior of American buyers of new cars. The key events in early 1979 that led up to this situation were as follows:

January 6	The Shah appoints Shahpur Bakhtiar as prime minister of Iran.
January 9	Bakhtiar announces that the Shah has agreed to leave Iran.
January 17	The Shah departs for Aswan, where he will be the guest of President Anwar Sadat.
January 18	President Jimmy Carter states that if Iranian oil exports are not restored, the United States must cut its oil consumption by 5 percent.
January 20	A million marchers rally in Teheran for the Ayatollah Khomeini.
January 29	Bakhtiar's peace initiatives collapse as violence erupts in Teheran.
February 1	Ayatollah Khomeini arrives in Iran after 15 years of exile.
February 12	Bakhtiar resigns.
February 18	Iran's new prime minister, Mehdi Bazargan, says that the Khomeini government may soon resume oil exports.
March 28	OPEC raises basic crude oil prices.

April 16	OPEC raises crude oil prices again.
May 16	Oil experts say that while the current gasoline shortage in California is not as severe as that in 1974, there is no clear prospect of an end.

The fuel shortages were transient but the fuel price increases were not. This made certain consumer attitudes more important in 1979 than they had been in the world of 1978. The economic downturn that ensued heightened their importance even more.

What were these attitudes?

One was that Japanese automakers were superior to American automakers in their abilities to design subcompact cars; achieve high levels of fuel efficiency; and, to a lesser degree, incorporate into their products advanced ideas in engineering and high-quality workmanship. These views were reflected by the ratings given to American and Japanese cars in the Automotive Consumer Profile prepared by J.D. Power & Associates of Los Angeles and issued in August 1979, following its survey during the period from May 1 to July 9 of slightly more than 5,000 individuals of driving age in 3,000 households throughout the United States (see Exhibit I).

Early in 1979, as the Iranian events were beginning to unfold, these attitudes were already influencing buyers of low-priced imported cars. Between April 9 and June 29, Beta Research Corporation of Syosset, New York, undertook a study commissioned by Newsweek Magazine in which 5,113 persons who had bought new domestic and low-priced imported automobiles in January and February were surveyed. The study results reflected, in particular, the different viewpoints held by buyers of low-priced imported subcompacts, most of them made in Japan, and buyers of domestic subcompacts. Exhibit II presents some of the factors cited by those buyers as influencing their purchase decisions.

The consumer views reflected in both the J.D. Power and the Beta Research studies, views held by a consumer population traumatized by a second episode of lines at filling stations, a second episode of sharp rises in fuel prices,

EXHIBIT I
RATINGS GIVEN TO AMERICAN AND JAPANESE CARS
(by percent of total respondents)

	American Cars				Japanese Cars			
	Excellent	Very Good	Good	Total	Excellent	Very Good	Good	Total
Fuel Economy	2	9	27	38	20	31	21	72
Workmanship	6	14	29	49	6	19	32	57
Advanced Ideas in Engineering	8	18	33	59	10	23	31	64
Ability to Design Subcompact Cars	6	14	30	50	23	29	23	75
Value for Money	9	20	32	61	9	23	30	62
Dependability; Minimal Repairs	9	19	32	60	4	14	32	50
Passenger Comfort	26	29	23	78	3	4	32	39
Availability of Parts and Service	28	28	19	75	2	9	25	36

Source: J.D. Power & Associates, Automotive Consumer Profile, August 1979, Volume 1.

EXHIBIT II
FACTORS CITED AS INVOLVED IN THE DECISION TO PURCHASE A NEW CAR

	Buyers of Domestic Subcompacts	Buyers of Low-Priced Import Sedans*
Better Gas Mileage	82.4%	81.7%
In My Price Range	55.2%	36.4%
Uses Regular Gas	0.4%	34.9%
Front-Wheel Drive	23.3%	34.6%
Better Quality of Workmanship	7.2%	27.2%

Include 9 Japanese models and 5 European models.

ource: Beta Research Corporation, Buyers of New Imported/Domestic Cars, 1979.

and a decline in real earnings, were evident in new car sales over the period 1976-1981. As the data presented in Exhibit III indicate, during this period, overall sales of new cars shrank while sales of those vehicles perceived to be the most fuel-efficient cars and the best subcompact cars increased in absolute number as well as in market share.

This occurred very quickly, and in two jumps. The first jump occurred in the second quarter of 1979 under the impact of the motor fuel availability and price situation; the second occurred in early 1980 as the combination of motor fuel concerns and the decline in consumer spending power seemed to heighten the trend toward the purchase of Japanese cars (see Exhibit IV).

Most of the growth in consumer purchases of Japanese cars was in the lowest priced models offered by the leading exporters. Nearly 70 percent of the sales gains registered cumulatively by Toyota, Datsun, and Honda in 1979 were for these low-priced series (see Exhibit V).[3]

In 1979 and succeeding years, American consumers were substantially changing their automobile buying habits. In terms of their knowledge and perceptions of American and Japanese cars, the 21.3 percent of new car buyers in 1980 who opted for Japanese products were behaving in a wholly understandable, rational manner.

EXHIBIT III
DEALER NEW CAR SALES, 1976-1981

	Japanese Unit Sales (000)	Japanese %	All Imports %	Total Unit Sales (000)
1976	931.2	9.2	14.8	10,102.0
1977	1,357.7	12.1	18.5	11,176.8
1978	1,336.7	11.8	17.6	11,307.5
1979	1,755.9	16.4	21.8	10,648.8
1980	1,908.2	21.3	26.7	8,976.5
1981	1,858.6	21.8	27.3	8,533.0

Source: Ward's Automotive Reports.

EXHIBIT IV
1979-1980 NEW CAR SALES BY QUARTER

		Total Unit Sales (000)	Japanese Unit Sales (000)	Japanese %	Earning Index
1979	Q1	2,739.7	402.1	14.7	98.9
	Q2	2,944.4	510.1	17.3	96.5
	Q3	2,570.4	432.4	16.8	95.8
	Q4	2,394.3	411.3	17.2	94.6
1980	Q1	2,510.2	531.3	21.2	92.1
	Q2	2,138.8	480.0	22.4	89.9
	Q3	2,126.8	468.6	22.0	90.7
	Q4	2,200.7	428.3	19.5	90.7

Sources: Automotive data from Ward's Automotive Reports; earning index is average weekly earnings per worker in constant dollars (December 1978 = 100), based on average weekly earnings per worker (private, non-farm) in constant dollars (1967 = 100), seasonally adjusted, as reported in Survey of Current Business, U.S. Department of Commerce, Bureau of Economic Analysis:

Dec. 1978	104.41
Mar. 1979	103.31
June 1979	100.79
Sept. 1979	100.04
Dec. 1979	98.73
Mar. 1980	96.12
June 1980	93.91
Sept. 1980	94.75
Dec. 1980	94.70

EXHIBIT V
PERCENT OF U.S. SALES OF THREE LEADING JAPANESE PASSENGER CAR BRANDS ACCOUNTED FOR BY LOWEST PRICED SERIES
(1978-1979)

	Total Unit Sales (000)	Lowest Priced Series*	
		Units (000)	%
1978 (full year)	1,054.8	528.5	50.1
1979 Q1	305.2	167.8	55.0
1979 Q2	376.5	206.1	55.0
1979 Q3	340.6	184.0	54.0
1979 Q4	311.1	164.8	53.0

*Includes Toyota Corolla, Tercel, and Starlet; Datsun 210 and 310; and Honda Civic.

Source: Ward's Automotive Reports.

CHAPTER 3
IMPORT RESTRAINTS AND THEIR RESULTS

During the last six months of 1980, U.S. sales of domestically manufactured new cars trailed prior year sales by percentages ranging from 8.5 percent in October to 31.0 percent in August.[4] Indefinite layoffs among the four domestic passenger car manufacturers were reported at 189,250 in the December 29, 1980, issue of Ward's Automotive Reports. Temporary layoffs accounted for an additional 49,050 workers.

Pressures increased for some form of relief. The outgoing U.S. secretary of transportation attached to his last report on the automobile industry a recommendation that the president negotiate an import restraint agreement with Japan. In early February 1981, the special trade representative of the new administration expressed to the Japanese ambassador the belief that any trade restraint agreement concluded by Japan with the European Economic Community would force the U.S. government to seek similar sorts of restrictions. By mid-March, informal government-to-government pressures were increasing and the special trade representative, in testimony before a senate subcommittee, stated that the president had the authority to negotiate an automotive export restraint agreement.

On May 1, the Japanese Ministry of International Trade and Industry announced a two-year limit in exports to the United States of 1.68 million passenger cars per year. The period covered was to be April 1, 1981, through March 31, 1983, with a possibility of the limitation being extended for a third year. Cargo-carrying vehicles, including station wagons, were excluded from the total. At the time of the announcement, as reported in Ward's, the total number of American passenger car workers on indefinite layoff was 169,069, along with 27,300 on temporary layoff.

During the first year of the import restraints, sales of domestic-made subcompact cars, the models with which Japanese cars competed most directly, declined, although their share of the total market increased slightly; however, so did that of the Japanese cars. (See Exhibit VI.)

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EXHIBIT VI
SELECTED DATA ON SALES OF NEW CARS
(April 1980 - March 1982)

	April 1980-March 1981	April 1981-March 1982
Total New Car Sales (000)	8,842.5	8,102.4
Sales of Domestic Subcompacts* (000)	1,666.9	1,612.0
Sales of Japanese Cars (000)	1,895.1	1,783.8
Market Share: Domestic Subcompacts	18.9%	19.9%
Market Share: Japanese Cars	21.4%	22.0%

*Include General Motors J-series cars whose wheelbase exceeds 100 inches, traditionally considered the upper limit of the subcompact class. (Note: The GM J-series cars added 186.4 thousand units to the April 1981-March 1982 total for "domestic subcompacts." If they had been classified as "compact," the revised total for domestic subcompacts would have been 1,425.6 thousand and the market share 17.6 percent, a decline of 1.3 percent from the prior 12-month period.)

Source: Ward's Automotive Reports.

At the end of the first year of the import restraints, Ward's – in its April 5 issue – reported domestic automaker layoffs at a record level. Indefinite layoffs had reached 254,000 in the prior week, a level 50 percent higher than that which existed a year earlier. Temporary layoffs, however, were reported at 19,525, a decline of approximately 8,000 from the prior year.

Inventories of Japanese cars as of March 31, 1982, were calculated at 43 days' supply, slightly up from the 34 days reported a year earlier but still reflecting a tightness of availability. The most popular domestic subcompacts were reported by Ward's to have 48, 57, and 69 days of inventory, considered relatively normal but still representing a substantially greater availability than Japanese passenger cars.

Consumer behavior during the first year of import restrictions seemed to reflect a continuing belief, at least among 22 percent of new car buyers, that Japanese vehicles offered greater value, at least in the personal terms used by these consumers for defining "value."

CHAPTER 4
COSTS AND BENEFITS

The expected scenario underlying the pressure placed upon the Japanese government to limit exports of passenger cars to the United States was one in which a decreasing availability of Japanese cars would lead American consumers, confronted with an artificially imposed scarcity of these cars, to elect to purchase an American subcompact car. This, in turn, would stimulate both employment and the financial fortunes of the American automakers.

In terms of first-year benefits, unit sales of American-made subcompacts – the vehicles that most closely approximate Japanese cars in terms of size and pricing, especially at the lower and middle ends of the pricing range – actually declined, although their share of the market increased by 1.0 percent.[5] (During the first three months of 1982, the domestic subcompacts have continued to increase their share of the market but, again, so have the Japanese cars.[6]) The growth in market share of the domestic subcompacts has been attributed by many observers, at least partially, to direct or indirect price concessions offered by manufacturers. These concessions, however, have also diminished the favorable financial impact on the manufacturers involved.

With regard to employment at the domestic automakers, the overall situation has worsened rather than improved. Depending on the assumptions used, "What if . . . ." sorts of calculations might indicate a net gain in employment due to the export restraints on Japanese cars, but even with the most favorable assumptions these would appear to be nominal at best.

Our analysis will be directed toward attempting to estimate the incremental costs of such nominal benefits to each of the 1.78 million American consumers who, perceiving Japanese small cars to provide better value, chose during the first year of these restrictions to purchase a Japanese car.[7] We will examine three aspects of incremental cost:

(i) Is there any evidence that Japanese automakers and their importing subsidiaries have seized upon the artificial shortage of their vehicles and applied opportunistic pricing policies in the U.S. market?

(ii) Have the Japanese automakers, confronting a freeze in the number of cars they can export to the United States, upscaled the mix of cars they are exporting toward those at the higher end of their price ranges?

(iii) Is there any indication that franchised dealers of Japanese cars have used the consumer perception of scarcity of such cars to extract higher profit margins in selling these cars?

We will examine each of these questions individually and then develop a cumulative quantification of our findings by eliminating any instances of possible double counting.

CHAPTER 5

INCREASES IN STICKER PRICES

By how much did the sticker price of Japanese cars in the United States increase during the first year in which the import restraints were imposed?

To estimate this, we chose the seven leading model series by volume of sales in the 12 months starting April 1981 – Toyota Corolla, Datsun 210, Honda Accord, Honda Civic, Toyota Corolla Tercel, Toyota Celica, and Subaru – and found that they, together, accounted for approximately 59 percent of the unit sales of Japanese cars during that period.[8] We also compiled the list prices for one representative model in each model series as of April 1, in both 1981 and 1982, and, based on respective sales levels, compiled a sales-weighted composite price at each of these dates. The price increase reflected in this composite was $360, or 5.8 percent.[9]

We compared this degree of price increase with the prices of Japanese cars in the Japanese domestic market over the same period of time. According to the Statistical Bureau of the Office of the Prime Minister, the new car price index in Japan rose 5.1 percent from March 1981 to March 1982.[10] Of this increase, 2.5 percent was attributable to an increase in the commodity tax on both small and large cars implemented in May 1981. Therefore, the actual level of price increase was 2.6 percent.

It seems reasonable to assume that the difference between our estimated U.S. price increase for Japanese cars of 5.8 percent and the Japanese domestic price increase of 2.6 percent must be attributable to a view on the part of the manufacturers and their American subsidiaries or affiliates that American market conditions – influenced primarily by the scarcity of Japanese vehicles – would absorb higher prices. Therefore, we believe that 55 percent of the American price increase – $198 for our composite of the seven most popular model series – is traceable to the scarcity of Japanese cars created by the export restraint.

During the same period, the relationship between the value of the dollar and the yen changed drastically. The value of the yen dropped 15.5 percent against the dollar from March 1981 to March 1982.[11] Had the Japanese automakers found themselves in an intensely competitive market during the year, one in which they were competing strongly against American manufacturers and against each other to increase unit sales and market share, they might have used price decreases permitted by the currency situation as a competitive tactic, passing on to the American consumer all or part of the benefit of the strengthened dollar as an incentive to buy Japanese cars in larger volumes. Renault, in fact, did exactly this; the April 1982 price of the least costly version of Le Car was more than $200 less than it had been a year earlier.[12] The Japanese automakers, however, felt no need to follow these sorts of competitive tactics. As we have seen, they raised the prices of their vehicles in the United States to an even greater degree than they did in their home market. Further, the 15.5 percent increase in the number of yen obtained for each dollar of passenger car exports to the United States became additional profit.

If the 15.5 percent gain in the dollar against the yen had been passed along to the American consumer, this would have amounted to a saving of $957 per car based upon our composite April 1, 1981, price for the seven most popular Japanese model series.

Therefore, we estimate that the combination of scarcity-based pricing and the absence of any need to pass along to the American consumer the benefits of a strengthened dollar added as much as $1,155 to the outlay made by an American buyer of a Japanese car during the first 12 months of the trade restraint.

CHAPTER 6
IMPORT MIX

Just as the first European cars established a beachhead in the American market through a combination of utility and low price, these same attributes facilitated the entry of Japanese cars into this market. Even though the Japanese automakers have steadily and successfully introduced more luxurious models to the American consumer, as recently as 1981 the three lowest priced model series offered by Toyota, the leading exporter to the United States, accounted for 69 percent of that company's unit sales.[13]

But, faced with strong and rising demand for their cars and a fixed unit sales level through the MITI-imposed export restrictions, have Japanese automakers upscaled the mix of vehicles they ship to the U.S. market?

From April 1, 1980, to March 30, 1981, the average landed value of Japanese passenger cars imported into the United States was $4,376; during the next 12 months, the first 12 months of export restraints, the average landed value rose to $5,144, representing a jump of 17.6 percent.[14] We have estimated that prices of individual Japanese cars increased by 5.8 percent during that period. The difference between these two figures, 11.8 percent per car, is attributable to an upscaling of the mix – including higher proportions of more expensive model series and lower proportions of inexpensive model series.

As a result, then, of the export restraints, in the past year the American consumer who perceived higher value in Japanese passenger cars than in domestic ones had to – on balance – accept a more luxurious mix of models than he or she had voluntarily chosen in the past. If our estimated "upscaling percentage" – 11.8 percent – is applied to the composite April 1, 1981, sticker price of $6,191 for the most popular Japanese cars, this means that an additional penalty – an upscaling penalty – of $734 has been placed on each consumer purchasing a Japanese passenger car during the first year of export restraints.

CHAPTER 7
A PROSPECTIVE VIEW

What will happen to the American consumer's interests if a domestic content law is enacted?

Most versions of such a statute limit its scope to those manufacturers whose U.S. imports exceed 100,000 units (passenger cars and light trucks) per annum. Based on historic sales, five Japanese companies would be affected: Toyota, Nissan, Honda, Mazda, and Subaru.

Honda is currently completing the construction of a passenger car assembly plant at Marysville, Ohio, which will produce the Honda Accord, the company's highest priced vehicle. Honda estimates that when the Marysville plant is in full production its output will be 150,000 Accords each year.[15] Under H.R. 5133, the version of the automotive domestic content legislation supported by the United Automobile Workers,[16] Honda would be required by model year 1985, the third full year of the plant's existence, to achieve at least 25 percent domestic content. If it achieved as high as 67 percent domestic content on U.S. production of 150,000 Accords, Honda could import up to an additional 50,000 vehicles. (In its third year of U.S. production, nondomestic content of the Volkswagen Rabbit has been averaging approximately $1,760 per unit, according to an analysis published by the Bureau of the Census.[17] The dealer price of the most basic Rabbit is about $5,300, so a rough estimate of Volkswagen domestic content is 67 percent of price. Despite production in 1981 of approximately 210,000 units at the Volkswagen factory in Westmoreland, Pennsylvania, and freedom to choose the most advantageous sources of componentry, foreign or domestic, Volkswagen is estimated by Harbridge House to have recorded a loss per passenger car manufactured of nearly $600.)

Nissan is constructing a light truck plant in Smyrna, Tennessee. At full production this plant will produce 180,000 units a year. If the plant reaches at least 56 percent domestic content, Nissan might then import up to 20,000 passenger cars.

Whether Toyota, Mazda, or Subaru, faced with a domestic content requirement, would elect to manufacture in the United States is speculative. Whether Honda or Nissan would choose to increase its American manufacturing commitments is equally speculative. Honda, because it will be producing a relatively high-priced car in this country, will probably have a better chance than Volkswagen of doing so profitably. Volkswagen has been losing money steadily in attempting to assemble in Pennsylvania a vehicle comparable in character to the low-priced models that account for between 50 percent and 60 percent of the cumulative sales volumes of the five Japanese companies. Further, no higher priced vehicle of any of the other four manufacturers is sold in large enough volume in the United States – like the Honda Accord – to probably justify an economically feasible, dedicated American manufacturing program.

So, if Honda passenger car availability were to become 200,000 units per year; Nissan passenger car availability 20,000 units; and the passenger car availabilities of Toyota, Mazda, and Subaru 100,000 each (assuming that Toyota and Mazda would channel their entire quotas of vehicles into passenger cars), their collective total would shrink from the 1.78 million level recorded from April 1981 to March 1982 to 0.52 million, representing a decline of 70 percent.

This, of course, is much greater than the cutback in availability established through the current voluntary export restraints. Will there, however, be a real scarcity?

The view of Japanese cars currently maintained by a high percentage of the auto-buying public will probably persist, and it will be reinforced by the fact that in 1985 all three of the principal domestic automakers will prominently have Japanese-made small cars in their product lines.

In the event of a much greater scarcity of Japanese cars, what sort of situation will the American consumer confront?

- Will the Japanese automakers increase their U.S. prices disproportionately because of the likely excess of demand over supply? As we have seen, they have done so in the past year, a year in which product scarcity has not been as extreme as it would be with a cutback of more than 40 percent.

- Will the Japanese automakers upscale the mix of vehicles they offer in this market in order to offset in revenues their sales loss in units? Again, they have done this to a marked degree under current circumstances; accordingly, we would expect this tactic to be employed even more drastically.

- Will those dealers who supply Japanese cars take advantage of the scarcity not only to avoid offering consumers discounts off the "sticker price" but also to charge prices even higher than those on the sticker? There is no evidence that dealers for the three leading makes of Japanese cars have been doing this during the 12 months starting April 1981. Very likely the weakness in overall demand for new cars of all types has constrained them from attempting such action. But, in the past when the scarcity of particular models or brands of Japanese cars has occurred, there has been ample evidence that dealers have done so, typically through two means. The first has been by charging as much as $600 for "additional dealer profit," a tactic widely reported in the trade press. The second has been by applying to each car a wide range of interior and exterior "protective treatments" that currently carry a "list price" of approximately $700 but which typically cost the dealer around 20 percent of the "list price." We would expect that a severe scarcity of vehicles would induce dealers, as in the past, to use these two mechanisms to artificially increase the prices of such cars by approximately $1,300 each.

- Will the domestic manufacturers raise the prices of their own American-made subcompact cars to a greater degree than the prices of their other models? American manufacturers readily concede that they lose money on U.S.-made subcompact cars. The most recent admission of this was from Ford Motor Company, with regard to its new Escort/Lynx family of subcompacts. In good times, the automakers cross-subsidize these losses with earnings from the sale of their larger, more profitable vehicles.

> In the 12 months from April 1981, they have not raised the prices of their subcompacts to a greater degree than the prices of their other series. By raising them to the same degree, their percent of price increase was still greater than that of the Japanese importers. However, if the Japanese firms are led to increase their prices sharply, the domestic manufacturers have shown in the past that they are ready to follow suit, choosing to improve profit margin per unit rather than to pursue growth in unit volume and market share by underpricing their competitors.[18]

How much of a surcharge would this impose on the American consumer who chooses, despite these penalties, to purchase a Japanese passenger car? Certainly, a minimum estimate would comprise the current surcharge of nearly $1,900, plus an additional $1,300 that a dealer would be likely to add for "additional dealer profit" and unwanted "protective treatments." Almost certainly, then, the minimum consumer surcharge imaginable would be $3,200.

How much greater might such a surcharge be? Predicting this would be pure speculation. Almost surely, though, Japanese automobile exporters and their U.S. importing and marketing subsidiaries would attempt to offset the loss of unit sales volume, as they have in the first months of the voluntary export restraints, by continuing to increase U.S. prices at a more rapid rate than prices in their domestic market and by continuing to upgrade their sales mix.

FOOTNOTES

[1] All data as reported in Ward's Automotive Reports:

	1973	1977	1978
Dealer sales of new cars:	11,408,633	11,178,844	11,307,547
Retail sales of import cars:	1,738,944	2,064,254	1,990,917
Dealer sales of large domestic cars (intermediate, full size, luxury):	--	5,787,535	5,726,480

[2] The retail price of regular grade gasoline, excluding taxes, in 55 U.S. cities was $0.564 in mid-December 1978 and $1.051 12 months later, as reported in Survey of Current Business, U.S. Department of Commerce, Bureau of Economic Analysis, January 1980.

[3] As reported in Ward's Automotive Reports, unit sales of Toyota, Datsun, and Honda cars increased by 278.6 thousand between 1978 and 1979; unit sales of their lowest priced series increased by 194.2 thousand.

[4] Individual monthly totals drawn from Ward's Automotive Reports:

	Decrease from Prior Year Sales
July	21.3%
August	31.0%
September	19.1%
October	8.5%
November	12.3%
December	15.6%

[5] See Exhibit VI, Chapter 2.

[6] According to data reported in Ward's Automotive Reports, U.S. subcompacts held 21.4 percent of the total market in the first quarter of 1982 and Japanese cars held 22.8 percent.

[7] Ward's Automotive Reports.

[8] Sales data as reported in Ward's Automotive Reports; weightings calculated by Harbridge House:

	Unit Sales (000)	Weighting Among Top Seven
Toyota Corolla	204.7	.195
Datsun 210	146.3	.139
Honda Accord	180.0	.171
Honda Civic	142.1	.135
Toyota Corolla Tercel	121.6	.116
Toyota Celica	104.0	.099
Subaru	150.8	.144
	1,049.5	
Total Japanese Cars Sold	1,783.8	

[9] Price data as reported in Automotive News 1982 and 1981 Market Data Book Issues:

	Price as of	
	April 1, 1981	April 1, 1982
Toyota Corolla Deluxe 4D, 5S	$5,808	$6,018
Toyota Corolla Tercel Deluxe 2D, 5S	5,248	5,378
Toyota Celica GT 3D Liftback 5S	7,659	8,389
Datsun 210 Deluxe 4D	5,739	5,989
Honda Civic 4D, 5S	6,499	6,749
Honda Accord 3D Hatchback 5S	6,999	7,399
Subaru Deluxe 4D	5,579	6,238

[10] Automobile price index (1975 = 100) from the Statistical Bureau of the Office of the Prime Minister; indices for March 1981 and March 1982 were 113.5 and 119.3 respectively.

[11] According to Federal Reserve Bank of Boston data, in March 1981 the average yen-to-dollar exchange rate was 208.9; in March 1982 it was 241.2.

[12] Based on data reported in Automotive News 1982 and [illegible] 1981 Market Data Book Issues.

[13] As reported in Ward's Automotive Reports, 1981 sales of Toyota Corolla, Corolla Tercel, and Starlet series reached a total of 395.7 thousand units out of an overall Toyota total of 576.5 thousand.

[14] Data from the Bureau of the Census, U.S. Imports for Consumption and General Imports. Four TSUSA (Tariff Schedules of U.S. Annotated) commodity numbers were covered:

6921010	Four-wheel passenger cars, new, 4 cylinders and under
6921015	Four-wheel passenger cars, new, over 4 but not over 6 cylinders
6921030	Four-wheel passenger cars, new, over 6 cylinders
6921035	Four-wheel passenger cars, new, except piston engine type

The average landed value of Japanese cars in these categories from April 1980 through March 1981 was $4,376; from April 1981 through March 1982 it was $5,144.

[15] Ward's Automotive Reports, February 15, 1982.

[16] "Fraser Says UAW Picking Up Pace of Campaign for Domestic Content Legislation," News from the UAW, May 4, 1982.

[17] Same report identified in footnote 14, above.

[18] The Imported Automobile Industry, Harbridge House, Inc., June 1979, pages 49-51.

Chairman GIBBONS. I can hardly wait to turn you all over to Mr. Bailey.

I will recognize Mr. Frenzel first.

Mr. FRENZEL. I am not going to be as much fun as Mr. Bailey. I want to thank you for the testimony which I think is corroborative of much of what we heard since we began these hearings.

I am not sure that the eye of the Congress is on these hearings, but if it were, there would be quite a different impression abroad about this bill than what we hear.

Mr. Zinn, you indicated or called this a jobs bill, a bill to steal your jobs. One of our Congressmen who testified before us the other day demanded of this committee to know what our moral basis was for deciding that we should steal jobs from one sector to protect some in another sector.

Do you think there is any legitimacy to that kind of operation? Apparently you don't, or you wouldn't have made that statement. Does that bother you?

Mr. ZINN. Yes, it does bother me. As I said before, I had a very humble beginning. I would have liked to have been a domestic automobile dealer, but I think I would have been laughed out of the office with my available supply of capital and facility.

I went the only route I could. I worked in a Chevrolet dealership as a salesman for 9 years to save up that $7,000. What did I do wrong? I worked like a mule; I am a workaholic; my wife and I constantly battle over my 70-hour weeks, which I still put in. I was in my office in Miami at 6:00 this morning, left for the airport at a quarter to 7 to catch a 7:40 flight, and here I am.

This is the type of day I still put in. I didn't do anything wrong, and I resent somebody from Detroit coming to my place of business, so to speak, and saying, "Hey, you have to let half of your people go because we want to give their jobs to our sector, because the manufacturers in Detroit missed the market."

They didn't make what the public wanted to buy and we have to give them more time.

Chairman GIBBONS. You don't understand. They are trying to save your health and your marriage.

Mr. FRENZEL. I have to be sympathetic with that point of view. I appreciate your testimony. I hope that some people down here are hearing that good word. Those who are coming to us asking for relief are saying, "Hey, why should we be penalized by these awful things that are happening elsewhere in the world?"

I guess much of your testimony is showing us that the horrible things are happening here. It is our recession; it is not—we are mixing cause and effect.

Mr. ZINN. Right.

Mr. FRENZEL. It is not the Japanese who are sending cars in here to louse up our market. They are doing that because they have good cars at a good price, but our basic problem here is that we are not selling any cars, we have an economy that is dead, and there is no sense in blaming that on all the other people, both here and abroad, like yourself and asking you to pay some price.

It is—to me, it seems like a misery-loves-company bill. As long as I am unhappy, let's see how many others we can make unhappy.

Then, if we do that, perhaps we can all pull ourselves down.

Anyway, I think your testimony has been very helpful in that respect.

Mr. McElwaine, you were talking about accessibility of market in Japan and the costs of alteration. Sometime, we need to talk about that a little bit more. I guess I am not as convinced it is—I am wholly convinced the American companies have not made aggressive attempts to market in Japan.

I would agree with you. On the other hand, I am not wholly convinced that that is such a pleasant place to do business even when aggressive marketing techniques are used.

Mr. **McElwaine**. I agree, Mr. Frenzel. It is a very difficult country to do business in. Their customs and ways are so vastly different from ours. We talked about the automobile dealerships and the fact that they have exclusive dealerships—they have more than just exclusive dealerships. They don't have Toyota dealerships, for example.

They will have a Corolla dealer, or a Celica dealer, or a Supra dealer. They sell only one line of Toyota and they have different dealerships for each one. A lot of these dealerships don't even have showrooms because space is so limited in Japan.

They sell their cars by sending their salesmen out door to door, and they knock on doors and show a brochure of what the car is they are selling. If the customer is interested, they will bring one to the customer.

None of the American firms have tried to sell cars that way. As a matter of fact, there has yet to be a brochure on an American car printed in Japanese. When we went to Japan, we asked to see some literature; it was all in English, because they have never printed a brochure in Japanese, which wouldn't indicate any real serious desire to penetrate that market, but it is not terribly easy to, either.

Mr. **Frenzel**. I agree with you that that is true. On the other hand, people like Mr. Gibbons and myself and others who feel it is important to keep the trading system open, which is a benefit to us as well as Japan, have to continuously remind our friends over there that if they are smart enough to sell in this market, they are smart enough to buy in their own market, and you are not going to be able to sell forever until you buy something.

They have steadfastly refused to accept that message, and those of you that do business with them might, I think, be well advised to try to help us transmit that. We don't expect them to do our work for us. We have a lot of work that we have not done well.

On the other hand, their culture resistance and other general grudging resistance is—makes our job very difficult in trying to protect the benefits for all countries in the free system.

I wanted to talk to you about your world car concept and economies of scale, because I got the impression that you thought that that was the first time it was raised. Secretrary Baldrige raised that point particularly in his testimony and questioned whether this bill would not immediately spell the end of the world car concept.

I am glad that you raised it again. It passed me until you mentioned it, and then I went back and reviewed his testimony. I asked Mr. Caldwell—I did not ask Mr. Smith about the subject—and he sort of passed it off and was nonspecific, but said it wasn't important, but you are quite sure that that is the principal target and will be an inevitable result?

Mr. McElwaine. This is very strongly my feeling, because I cannot believe that Doug Fraser, whom I have known for many years, and respect and admire, really sincerely believes that passage of H.R. 5133 is going to have the Japanese manufacturers falling all over themselves to build factories in the United States, as his prospectus on this bill would claim.

Since that won't happen, what is the real accomplishment of the bill? The real accomplishment of the bill is that it prevents Ford, General Motors, and Chrysler from achieving economies of scale through outsourcing around the world. That is the only benefit that is left without the transfer of production from Japan to the United States.

So that would lead me to think that this is the real objective of this bill, that General Motors, Ford, and Chrysler are the targets far more so than we, although we would get splattered in the attack as well as they.

Mr. Frenzel. Well, I think you would be the first casualty.

Your statement, on page 12, about magic tricks is, of course, something that bothers us here right along. We have a Congress in which we like to legislate results. We are not very good at programs or policies, and so we like to have wonderful statements that say the sky will be blue and it will only rain after sunset and bellies will be full——

Mr. McElwaine. And the budget will be balanced.

Mr. Frenzel. The budget will be balanced, programs will be efficient, but it doesn't happen that way. You have to work at it every day. You did a good job of pointing out we have a lot of things to do. The magic tricks, the magic bullets, the legislative results are not just going to happen. It takes a lot of good, solid hard work every day.

It takes a lot of cooperation between employees, employers, and Government in this country. It will take a lot of cooperation between our trading partners abroad, which I still believe we are not seeing. I understand it. I can understand their unwillingness to cooperate when we are firing cannons here from all sides to sort of inspire them to fits of meanness, but we have a long way to go on this.

I think you people have done a good job in pointing out some of the directions we have to travel. I thank you for your statement.

Thank you.

Chairman Gibbons. Mr. Bailey?

Mr. Bailey. Thank you, Mr. Chairman. I can't imagine why you asked if I wanted to question the witnesses here, but I am very grateful for the time.

Page 4, Mr. McElwaine, of your statement, refers to labor costs. You start off in the first complete paragraph on that page and say:

> It is economies of scale, not lower labor costs, inventory controls, or better management, that have given the Japanese manufacturers the cost edge over Detroit.

Let's stop right there. Do you think that there is not a management difference issue in terms of ability?

Mr. McElwaine. I don't think the management issue is nearly as important as simply the volume efficiencies that are achieved through economies of scale.

Mr. Bailey. Well, sir, given your theory of the economies of scale—and by the way, I am not being critical, I am learning—given your idea of that theory or that idea, was it because of an erroneous management decision that there was a different policy followed on the part of the Japanese and American management?

Mr. McElwaine. No. I think you have traced the source of most of Detroit's management errors quite sharply. You have traced it right back to the building we are sitting in today. Detroit's policy of spreading their manufacturing facilities around the world, of building in the market countries where they were selling, were based on incentives, tax incentives built into U.S. tax policy from the end of World War II on.

It made it much more advantageous for them, not only our tax policy, but the tax policy of the host countries, for them to export capital than it was to build a product in the United States and export the finished product.

Mr. Bailey. You will never know how pleased I am to hear you say that. Although we may disagree in the final analysis on the impact of effect of this two-by-four, I really believe that it is going to make us evaluate, in particular, some of our domestic tax and regulatory policy, which I believe has been at the root cause of this difficulty.

You are obviously a very knowledgeable fellow, and we have had some very knowledgeable people before the subcommittee from time to time but I have come to the conclusion that the reason many of our basic industries on which we rely, particularly for feed stock industries are in trouble essentially because of domestic policies which the Government has fostered through either regulatory or tax policy, and sometimes with specific goals that have harmed the environment in which our business and labor have had to work.

I am grateful to you for acknowledging that point. So you would say that the reason that Japanese automobile manufacturers found themselves in the particular environment that they are able to so effectively cope with today, so successfully deal in today, and the difficulties that our companies have in dealing with this manufacturing and marketing environment today, and how successful they have been, can be traced in, at least you feel, large part to domestic tax policies and that type of thing?

Mr. McElwaine. Certainly in the postwar years Japan's great need was to acquire hard capital, to get dollars, most significantly, into the country, so they encouraged the development of export corporations and export industries.

The United States at that time was engaged in a global Marshall plan, an attempt to rebuild the world so that the world could be viable and we could live in it.

Mr. Bailey. I thank you again. I made that point a couple of days ago.

Mr. McElwaine. They encouraged our manufacturers to export capital and build factories abroad.

Mr. **Bailey**. May I interrupt you and ask you one question in that connection? In connection with a response you made earlier about currency and how important it was, Mr. Fox from NAM made some statements concerning the currency concept, and said that—what caught my eye, incidentally, the point I am getting to is your difference of $20 an hour, roughly, for domestic labor costs and the Japanese labor costs of $12 an hour.

We hear consistent criticism about American wage rates.

But at 260 to 180, you are talking about roughly comparable, you say here, $17 an hour, labor costs. I want to thank you also for that information, because I think we do have to get these arguments in perspective in terms of labor costs, et cetera.

The truth is automobile workers around the world, because of the nature of the job—and many folks, I don't think, understand how complicated an industrial engineering type of job it is, the machinists work, some have the skill, et cetera, get paid pretty darned well in most countries.

Mr. **McElwaine**. The automobile workers in both Germany and Belgium today make more money than the automobile workers in Detroit.

Mr. **Bailey**. Thank you. That has been on the record. I thank you for reinforcing that. Mr. Fox said the Japanese have not consciously but have as a matter of policy encouraged a relatively devalued currency over the years because it made them stronger in the export area.

Does that have meaning in your analysis, in your way of thinking?

Mr. **McElwaine**. If this implies manipulation of the yen, I would have to say I disagree.

Mr. **Bailey**. He specifically said that he wasn't indicating a direct manipulation. It seemed like he was saying as a matter of custom, or practice, that it had developed that way.

Mr. **McElwaine**. For any export-dependent country, and Japan is probably the most export-dependent country in the world, almost without exception. They would die without their exports.

I would think there would be a natural inclination towards an undervalued currency or at least slightly undervalued.

When it gets as badly undervalued as it is today, it gets to be a serious economic problem.

Mr. **Bailey**. Which is why you made reference to the attempts to prop it up, which is also widely known.

I just keep getting the feeling from our witnesses that this currency thing is something that needs to be looked at. We are short on solutions and are not quite sure of the origination of the problem.

Mr. **McElwaine**. I don't want to minimize its importance. You look at the current situation, the average car sold in Tokyo today comes off the factory line at about 2 million yen, its current price.

At 260 yen to the dollar, the current level, that translates into a little more than $8,000 here in the United States. At 190 yen to the dollar, it is $10,500. It is over a $2,000 swing that has taken place.

Now, the Japanese manufacturers during this tremendous drop in the value of the yen, have not reduced their prices in the United States, which means that they have got a $2,000 pad in their profits of their U.S. sold cars. That is a huge profit margin. Why haven't they cut their prices?

Well, because they are operating on a quota. They can sell every car that they are permitted to bring into the United States so why cut the price? As a matter of fact, Toyota just put in a substantial price increase, 10 percent on their most expensive car and 6 percent across the board. That is a huge price increase, on top of the profit that they are already making off the yen-dollar situation.

So the quotas are making a lot of money for them right now.

Mr. BAILEY. But you think that the currency question is something which deserves study?

Mr. McELWAINE. Absolutely.

Mr. BAILEY. You started off your comments with a reference to testimony we had just prior to yours about the openness of the Japanese market.

Mr. McELWAINE. I figured we would get to that.

Mr. BAILEY. I wasn't even planning to ask it, but the chairman gave me some extra time.

That is the area where I think I have the most difficult problem.

I really think that this legislation is not the best way to respond to the problem, and you seem to be telling me there is no problem, and that is where I have the greatest difficulty.

Are you saying we do have a problem and maybe it is totally indigenous; I don't know.

I don't share that view. I have never done business in Japan. I don't have that experience, but the vast weight of what I have been told or been able to read indicates that openness in the Japanese market is a very severe problem. The gentleman before you, who sounded very, very knowledgeable, seemed to feel it was not so much an official thing, but a matter of custom, and that sort of thing, but acknowledged there were problems, but maybe due more to custom and tradition.

Mr. Hutchinson, to whom you referred, if you were in the room during that testimony, and I wish to allay one fear of yours in terms of your domestic production, they do plan to open a plant in Michigan that would induce significant content, and they would be comfortably within the margins of the bill right now.

That is not really your basic reason to objecting to the bill, but on this openness thing, when Mr. Hutchinson testified, Volkswagen is the largest foreign seller in the Japanese market, and he said he did not have that much experience with it, and I don't wish to be unfair to him, but he seemed to indicate that Volkswagen was not happy with the experiences they had had in selling there, but he did say that they were selling a product which was considered a high-priced and expensive and prestigious product in Japan.

I have read material by Japanese who say that their markets are not open and their government acknowledges the fact that they have got to do more.

In fact, I know they made a change in their communications company, and I read an article recently, an interview with the leadership of that company about objections. I know the former chairman of the company; he said they would buy some telephone poles and a few things from us, but that is all the American equipment they were going to buy.

That caused a lot of anger.

Why do you feel so strongly that that market is as open? Do you think we are ignorant about selling in it? We don't know how? There have been a few people that market certain products there that say they are happy with it.

We had some testimony from people in the electronics area last year and said that they were pleased, and felt they could do business in Japan successfully.

Is it as open a market as ours?

Mr. McElwaine. My knowledge in this field is limited to the automobile field.

I am as aware as probably some members of this committee about the restrictions that the Japanese have on beef; that they have on citrus; and some of the other areas of protectionism that they seem to follow. But, you know, that is only from reading about it.

I have had actual experience over there, because we made a deliberate attempt on the visits there to find out as much as we could about the status of the automobile industry and about automobile imports there, and we saw nothing in all of our meetings and discussions and trips to change my feeling that the Japanese automobile market is restricted only by the unwillingness of the Japanese to try products that are new and different and strange, and the lack of interest of the American automobile manufacturers in developing that market for exports.

Mr. Bailey. They don't get discouraged?

Mr. McElwaine. No, I don't think so, because we are doing very well in that market.

Mr. Pease spoke earlier about the Chevette, and why don't we sell that in Japan?

General Motors is selling its new small car in the Japanese market, but it is made in Japan by General Motors' affiliate, Isuzu. It is the same car—the S-car that is being made in Europe, and made by General Motors there.

Ford is selling the Escort in Japan, and it is made by Toyo Kogyo, which is Ford's affiliate.

General Motors owns 40 percent of Isuzu.

Mr. Bailey. I thought they testified 44.

Mr. McElwaine. They acquired an additional 6 percent. Ford is the largest single shareholder in Mazda, Toyo Kogyo. They have 25 percent. It is a part of their international network.

Mr. Bailey. Could they own 51 percent?

Mr. McElwaine. Under Japanese law, it is my understanding they could, but whether or not they would be able to acquire that level of stock from the current shareholders, I don't know.

Mr. Bailey. That is worth checking into.

I must say to you that the weight of testimony is that it is very difficult to do business there, everything from borrowing money to, well, you just turn every corner, and you meet resistance.

People have said that they can market to the point where their technology is borrowed, and they find that they don't get any cooperation.

Mr. McElwaine. In 1979, the Japanese amended their capital laws permitting foreign firms to acquire up to 100 percent.

Mr. Bailey. Why did they do that? Do you know?

Mr. McElwaine. I would think it probably has something to do with the kind of outside pressure they were getting from the United States.

Mr. Bailey. Exactly, and I think that this is what this bill is growing out of, the publicity that occurred over these countervailing duty and dumping cases. It is in that context of that kind of complaint.

I don't know. Let's do away with this bill. You mentioned these American companies, and we have established the fact that we are very grateful to have on the record your opinion about the decisions that this management made in terms of a world car; either were largely encouraging by American domestic governmental policy, because that has been my reading.

I get tired of hearing American management and labor griping, and I don't think it is productive.

The Japanese businessmen are probably doing the same darn thing our businessmen will do, and that is to go out there and try to be profitable, and this gentleman is doing it in the best environment he can.

Do you have recommendations on what the best thing to do would be?

I was watching some of your reactions, I don't think there is a good free market out there. I think there are some legitimate complaints.

I think what we do have in terms of American quotas and restrictions are reactionary things, but I can at least compliment the American system on trying to push free trade. We have honestly tried to push it, generally speaking.

What would you recommend to us to do, look at our tax laws here? I know you don't want us to do this; that goes without saying.

Do you have any specific ideas on how to deal with the problem?

Mr. McElwaine. As you say, one of the things we should not do is to cut off the American manufacturers from making the best practical use of the factories that they have built around the world.

Why they built them, why General Motors is currently building six factories in Europe simultaneously, while curtailing their investments in the United States, are things that it is really useless to dwell on.

Mr. Bailey. When Mr. Hutchinson testified, he testified that the production at American Volkswagen was the most productive in the Volkswagen group. He said that that was the most productive facility, the most productive labor that they had.

You may want to think in terms of the idea of a Volkswagen having a bad experience and maybe thinking about pulling out or something. You related that to volume, but it sort of made me think, why not invest more in that American facility, or expand it?

Mr. McElwaine. They don't have the demand for the product. Their demand keeps falling below the breakeven point.

Mr. Bailey. Wouldn't you want to shift, if you could, your production to the States here?

Mr. McElwaine. We bear a strong responsibility for the existence of that factory in Pennsylvania, because it was this association that went to Germany in 1972 and sat down with the board of directors of Volkswagen and the Deutsche Bank and the German Ministers of Trade and Economics, and said, Volkswagen has got to come to the United States and build cars in the United States, or we are all going to be out of business.

This was purely an economic and financial matter, and I think we instigated the entire process that led to the founding of the Volkswagen factory in this country.

We have done the same in Japan. We have gone to Toyota and Nissan and said you have to set up manufacturing——

Mr. **Bailey**. Why?

Mr. **McElwaine**. To save our skins from a domestic content law, frankly.

At a time when the Japanese yen was at 190, it also would have probably been a very good move financially.

Mr. **Bailey**. They were in our area looking, and you probably are very much aware of that. I know some of the sites that they looked at.

Mr. **McElwaine**. It was no longer such a great investment.

Mr. **Bailey**. I threw that thing in about Volkswagen. You were going to suggest some alternatives to do about this volume thing.

Mr. **McElwaine**. You have to accept that these factories are in place, and I think that a bill that would prevent the manufacturers from making the most expeditious use of those foreign factories would be a serious blow to them.

The first thing is, yes, let them make use of it and achieve volume production of components in those issues, and even though it may be costly to us in terms of employment in some of our American factories. The alternative is greatly reduced sales volume, much higher priced cars, and eventually a lot fewer jobs; so it is the lesser of the various evils that you are faced with as far as employment is concerned.

I would certainly move to do something to encourage these manufacturers to bring capital back. Now, some of the tax breaks that have been given in recent tax bills have, by reducing the overall level of corporate taxes, brought some of that money back into this country. Still, last year, Ford Motor's annual report——

Mr. **Bailey**. You think a minimum corporate tax is a good idea?

Mr. **McElwaine**. I am thinking about the money they have abroad. Last year, Ford's annual report showed that they had, I believe, $50 million in cash in the United States, which, for a company the size of Ford, is sort of parking meter money.

At the same time, they had $2½ billion in cash in Europe at a time when they were strapped for capital in this country.

If they had brought that money back from Europe to the United States, they would have had to pay U.S. corporate taxes on it; so the money got reinvested in Europe, and this has been going on for decades.

Mr. **Bailey**. A corporate tax, itself, is a fiction we ought to do away with.

Mr. **McElwaine**. Perhaps, but at least we could experiment with something which is perhaps a moratorium on Federal taxes on repatriated earnings for a period of time, and let some of this money come back into the country to provide these corporations with the capital they need.

Capital is the real problem with our industry. They need more capital to modernize their plants.

Mr. **BAILEY**. It is not just the automobile industry. The whole country faces a reindustrialization problem.

I happen to be one who thinks that laws that are on the books dealing with countervailing duties and the response to subsidy provisions in the General Agreement for Trade and Tariffs are absurd. There is no way at all that we can deal with that situation.

I just wonder if the situation in Japan is one that is a model that should be emulated. If that market is as open, one should be able to argue that the relationship between industry and government should not be such that it should offend our sense of freedom.

Should we copy some things there? What should we do? I am not just talking about automobiles.

Mr. **MCELWAINE**. We are getting into areas of industrial planning and capital controls.

Mr. **BAILEY**. That is what is behind this. That is why this bill is here.

It is not United Automobile Workers trying to cheat this gentleman here who worked so hard all his life.

It is not evil, nasty management in Detroit dealing in some backroom, trying to twist out some things for themselves.

Some of these basic causes, an evaluation of this system, the Nation's military and diplomatic position, its economic security, et cetera—that is what is behind all of this.

That is why this lousy little bill out here has been kicking up such a fuss, because there are so many other complaints being thrown on the altar, because in a decent time, this bill would not even get sniffed at. Can we deal with it by our domestic tax laws?

Mr. **MCELWAINE**. We can help tremendously with our Federal tax laws. As far as these other matters you are getting into, I might have personal opinions about them. I am not sure I would be representing the feelings of my members in that particular situation, though; so, my chairman here might jump all over me.

Mr. **BAILEY**. I don't want to emulate their model. I don't think it is the most efficient.

Meanwhile, we are going to have to, as the huge strong economy that we really are in the world scene, we are going to have to do better than we have with enforcing some of these international agreements, because business practices are not in accordance with the spirit of what we have tried to recommend.

We have jawboned our steel industry literally to death in this country, and with all due respect, I didn't want to be unkind with the previous witness, I disagree with his endorsement of the efficacy and the effectiveness and the fairness, or whatever, of the laws that we have available to those people for redress.

State-side, that kind of business practice by a competitor would not get too far, and yet they constantly feel victimized by the practice, and it affects our investment patterns in this country.

What it has done is destroy the confidence of American investors, particularly in our capital-intensive industry. There is no confidence to put your money in that area in many, many ways.

Mining would probably be the best example in the group, and that is beyond the scope of this hearing, but automobiles are a part of that scene. It is our Government policies that have created this problem.

Mr. **McElwaine**. We tend to downgrade our own abilities and our own achievements, and it may explain the unwillingness in some cases to invest in some American industries, because, while some have been doing very badly, we remain at this point the most successful exporter in the world.

Somehow, we have managed to export 65 percent more than Japan does, although, you know, we profess such admiration for Japan's achievements, we are two-thirds again as efficient as they are as an exporter, and a lot of that is because our GNP is so much greater than theirs, but we export the same percentage of our GNP as Japan does.

Mr. **Bailey**. The reason there is a fear is that what is really happening, the Nation's responsibility for world security is probably very much at the root of the difficulty, because, when the argument arises, it always arises in some type of high-technology or capital-intensive structure that relates to the Nation's defense base.

It is a reaction to trends. There is a reaction to trends and our big industries have been sick men. We have had this kind of problem, and I think the reaction has been, and this is where I think you are wrong, and that is a fact that part of it is a little bit of irritation with the Japanese business practices.

They don't view this or that as being wrong or being a criminal or a sharp practice, and I don't know enough about how they do business to comment, but some people just feel that it is very unfair, and the other thing that causes Americans problems is, of course, the role of Government in the financing area. When you go back to your government and say, I have to swing a big deal on this big project somewhere, I have to have some financing, what are you going to do to help me? In France, you will get a lot of help. If you are here, you are not.

There is a different way of viewing the relationship between you guys and us guys.

Mr. **McElwaine**. In this respect, let me tell you about our experience in Japan, when we went to the Japanese automobile manufacturers in March of last year, and we went to them, and we said, you are going to have to restrict your exports to us.

This is our product, and we are selling it. We went to them and said you are going to have to cut back because if you don't, the Congress is going to cut us off at the knees, and instead of having 1,600,000 cars to sell, we will wind up with 1,200,000, or something. You are going to have to do it.

The Japanese objected in the most strenuous terms to this recommendation of ours, and one of their primary objections was they said for years now we have been accused of being Japan, Inc., of working hand-in-glove with the Government, but the automobile industry has never worked with the Japanese Government.

We have always been the maverick, and said no, we won't go along with you.

When the Government said we only will have two automobile companies, we said we will have six, eight, and all successful.

The Government has always tried to tell us what to do, and we never accepted it. We never took any money or financing from them, and now you, the dealers, are coming here and telling us we have got to become what you have accused us of being; that we have to become Japan, Inc., put ourselves inside of MITI, and let them control our industry, and that was their chief objection to our recommendation. But we said logic is not the important thing here. We are talking politics, and if you don't do it, we will all be in the soup.

Mr. BAILEY. They were a targeted industry early on.

It may not have been quite that way, I don't think. Maybe I am wrong.

Mr. MCELWAINE. They had a protective tariff, but it was really not——

Mr. BAILEY. You had prohibition.

Chairman GIBBONS. I have heard you say that, but we have not had any testimony to that effect.

Mr. BAILEY. I don't do those kinds of things.

Chairman GIBBONS. As far as I understand, the automobile industry in Japan has not been the planned industry, the blessed industry. As I recall, MITI wrote off the automobile industry as being noncompetitive. That is why I am always so suspicious of all this centralized state planning.

Mr. MCELWAINE. When Ford's affiliate, the Mazda Co., got into trouble here several years ago, MITI tried to write them off, fold it up, declare bankruptcy, and wipe it out. They refused and managed to save the company, and it is now Ford's most profitable affiliate in the world.

Mr. BAILEY. I will check into that. We have had testimony from some of the witnesses who said that at one time there was a prohibition or a limit that you could buy.

Mr. MCELWAINE. I am not familiar with it.

Mr. BAILEY. It was many years ago, but until the basic industry—

Chairman GIBBONS. 1937 or 1945.

Mr. BAILEY. It was supposedly a reaction after the war to their need to establish basic capital industry.

I thank you very much. I really appreciate the comments concerning labor, management, and that type of thing. I know we disagree on the legislation, and it may not ultimately be successful, but it will create a dialog that is absolutely vital, and this is where we disagree; it is absolutely vital to our friends in Japan.

I want that country hanging around as a democracy. There are some valid complaints, and I am sure there is wrong on both sides, but I am also confident that this system is open enough that it is going to be discussed before the final curtain comes down.

Thank you. Terrific testimony; absolutely.

Chairman GIBBONS. Mr. Vander Jagt?

Mr. VANDER JAGT. I am delighted that the gentleman from Pennsylvania took long enough to give me time to come back from the floor.

I merely wanted to take the opportunity to thank Mr. Zinn and Mr. McElwaine for really outstanding testimony. I am glad you got away from the dealership in Miami long enough to come up here.

I thought you made a terrific team, and the testimony was well delivered and excellent.

I wish to commend you.

Chairman **Gibbons**. I want to say as Chairman, I can always count on Mr. Bailey.

Don, I don't know what I would do without you.

You get here on time——

Mr. **Bailey**. It would not be as much fun.

Chairman **Gibbons** [continuing]. You get here on time, and you stay, and you are persistent, and you are a good member.

Mr. **Frenzel**. Don't encourage him, Mr. Chairman.

Chairman **Gibbons**. Our concluding witness for today is the National Automobile Dealers Association, Mr. Frank McCarthy, executive vice president.

We are glad to have you here, and I know you are tired.

STATEMENT OF FRANK E. McCARTHY, EXECUTIVE VICE PRESIDENT, NATIONAL AUTOMOBILE DEALERS ASSOCIATION, ACCOMPANIED BY H. THOMAS GREENE, EXECUTIVE DIRECTOR, LEGISLATIVE AFFAIRS

Mr. **McCarthy**. Many times we have had the opportunity to testify, and when we get on late in the afternoon, we look up, and we are lucky to see one Member of Congress.

We are very pleased that all you Members are still here, and it is a little bit unusual.

With me today is H. Thomas Greene, the executive director of legislative affairs of the National Automobile Dealers Association.

I am the executive vice president of the National Automobile Dealers Association, and on behalf of the association's 18,500 dealers that represent both import and domestic dealers, I would like to express our appreciation for the invitation to testify before you today on H.R. 5133, the Fair Practices in Automotive Products Act.

NADA opposes H.R. 5133, or any other local content proposal which would force manufacturers to build in this country or substantially reduce the number of vehicles available to the American consumer. Foreign investment should be based on economic decisions and not legislative fiat. Volkswagen of America and Honda are good examples of companies that, because of certain economic conditions, made decisions to build in this country.

There are a number of very serious and troublesome problems with local content legislation from an international perspective, such as a clear and admitted violation of existing treaty agreements and almost certain retaliation by foreign governments. However, I would prefer to concentrate on problems that would more directly and immediately impact on the small business automobile dealers of this Nation. As far as the small business dealer is concerned, we feel that local content legislation would adversely impact both domestic and import dealers.

Even our 11,000-plus only-domestic dealers are opposed to domestic content legislation.

We see very significant problems and inequities to this approach as a method of dealing with the high unemployment among automobile workers. All of the studies of which we are aware indicate a strong probability that such an approach will significantly increase the price of import and domestic cars to the American consumer. Also, it seems clear that the American consumer would lose a good deal of the choice which he now enjoys when making a purchasing decision for a new automobile. Model availability would certainly be reduced.

In addition, there is no real question in the minds of the small business dealers that enactment of H.R. 5133 would result in substantially higher unemployment among automobile dealers and their employees.

As everyone is fully aware, the automobile industry in this Nation is in the midst of one of the longest and most severe depressions in its history. It is our understanding that approximately 250,000 automobile workers, UAW, are currently unemployed. This unfortunate situation has been highlighted with frequency and well publicized in the media, as it should be.

A fact that has been less publicized is the staggering attrition and unemployment that has occurred at the retail level among automobile dealers and their employees. Since the current downturn began in 1979, approximately 3,500 new car dealers have been forced to close their doors, and over 120,000 dealer employees have lost their jobs.

As the retail merchants whose livings are made selling new cars and trucks, dealers are cognizant of one indisputable fact. High interest rates and high car prices have combined to price many potential new car buyers out of the marketplace.

New vehicle sales are price-sensitive. The periodic rebates offered by the manufacturers are a response to the desire by consumers for lower prices. It is for this reason that NADA has continually urged the manufacturers to lower the price of vehicles rather than to engage in rebate programs which stimulate sales only for the short period of the rebate program. One cannot underestimate the negative impact of increased prices on new vehicle sales.

Many rebate programs were in the magnitude of $500, and it would greatly stimulate sales 30 or 60 days, and as soon as the rebate was off, the payback period, sales dropped.

A difference in price of $500, $800, $1,000, has a tremendous impact on sales.

H.R. 5133 will aggravate an already perilous situation by unnecessarily raising new car prices for the American consumer who is already resisting higher prices. The Congressional Budget Office, the U.S. Department of Commerce, the U.S. Ambassador for Trade, and the President's Council of Economic Advisers have all testified on the inflationary impact of this bill.

By limiting foreign competition and the ability of the domestic manufacturers to search for the lowest price components, there is little doubt that the American consumer will have to pay higher new car prices. Increased prices will only serve to drive more consumers away from new car purchasers and ultimately retard the industry's revitalization program.

NADA recognizes and sympathizes with the plight of the unemployed autoworker. However, as previously noted, dealers and their employees have also suffered greatly during the past 3 years. It seems apparent that should this bill pass, additional UAW jobs will be created at the expense of further dealership closings, the loss of jobs by dealership employees, and the loss of jobs in export industries should the anticipated trade retaliation by other countries occur.

The exact net effect on employment of H.R. 5133 is uncertain. The Congressional Budget Office, for example, anticipates a net loss in jobs. What is certain, however, is that if this analysis proves correct, the U.S. Government would be redistributing employment, pitting the jobs of one sector of the economy against the jobs in another sector. NADA believes that this approach is patently unfair.

The solution to increased employment and a healthy domestic automobile industry is not the adoption of a domestic content bill whose benefits are dubious at best. Rather, it is to get the Federal Government on solid financial footing so that interest rates are reduced and sustained economic growth can ensue. Additionally, NADA would continue to urge the U.S. trade delegation to vigorously pursue corrections in the policies of other nations that inhibit free international trade.

NADA recognizes the frustration in dealing with nations whose trade policies fail to reflect a free market approach. Nevertheless, the United States should not abandon the principle of free trade for a domestic content law which will raise prices for the American consumer and further reduce auto sales.

For these reasons, NADA opposes H.R. 5133 and would urge the committee to reject this poorly conceived measure.

NADA appreciates the opportunity to testify before your subcommittee and would be happy at this time to answer any questions you may have.

Chairman GIBBONS. You say that even your American-only car dealers oppose this?

Mr. MCCARTHY. That is correct, Mr. Chairman. When we first examined this proposal, the immediate instinct was for domestic only dealers to tend to favor the legislation. They thought they might enjoy an immediate upturn in sales, some immediate profits which would help their cash flow.

Upon examining it, they recognized that the price of imported cars would go up substantially very quickly, and that the domestic prices would follow.They also were very much aware that in the period of the next 3 years up to 1985, that if the domestic manufacturers could not source their parts from the cheapest possible place; they would ultimately be forced to source them right here at possibly the highest price. Dealers knew both of these actions would result in higher new car domestic prices. Having been through 3 years of a downturn in sales, where the American public was very sensitive to the higher prices, they recognized that they would not profit by a local content bill.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

Thank you for your testimony. I appreciate it very much.

It has been a long day and yours has been corroborative of the others.

Can you simply tell me how did your organization come to this decision? Did you poll your members, your board of directors, or what?

Mr. McCarthy. We reviewed it with our Governmental Relations Committee, it went to our 58-member board of directors, and it was approved unanimously. We reported it to all of our dealers throughout the country.

There were a few places, namely, Detroit, where a few dealers raised some questions. I went there personally and presented these views, and not one dealer objected out of 60 dealers in the room. They recognized that in the longrun they would be worse off than they were today.

Mr. Frenzel. Mr. Chairman, may I yield the rest of my time to the distinguished gentleman from Michigan, Mr. Vander Jagt?

Mr. Vander Jagt. I appreciate the gentleman from Minnesota yielding to me. I don't really need the time, though, because I merely want to thank you for your statement. I think the story that you tell and the unanimous nature of the vote, and that meeting in Detroit with the dealers is a very, very impressive message. I thank you for bringing it to us.

Chairman Gibbons. I would say that of all the people who know the American market, your people, who are right on the firing line, know it better than anybody else in the world.

You are selling everyday, meeting customers everyday.

We can listen to economists and manufacturers and everybody else, but your people sell them.

I am very impressed with what you say about your own dealers.

Mr. Bailey?

Mr. Bailey. In every cloud there is some spot of sunshine that comes through, and, lo and behold, in your statement on page 4—I would like to also thank you—you say down at the bottom of the page, NADA recognizes the frustration in dealing with nations whose trade policies fail to reflect a free market approach.

I think the position taken by you and your dealers is very brave, and I am sure that it is one in which you believe. I realize your feeling about this legislation, and I respect your position.

Why did you put that sentence in your statement?

Mr. McCarthy. Well, the dialog today has expressed that, between certainly Japan and the United States, especially in the nonautomotive areas, there are certain areas where Japan has imposed restrictions on the importation of beef and other products.

Mr. Bailey. Have you read a lot about that?

Mr. McCarthy. I have read a lot about it.

Mr. Bailey. What experience do you have with the automotive side?

Mr. McCarthy. Certainly years ago, there were very stiff barriers to the United States selling in Japan. Everybody is aware of it.

Mr. Bailey. Thank you. I think a couple of times today I may have had my credibility in that area questioned, but we have had a lot of testimony from witnesses that indicated that there were serious barriers at least for a while in selling there.

You seem to think there are?

Mr. McCarthy. No question there were serious barriers some years ago.

Basically, various types of taxes that were heavily weighted to the larger size car, and since almost all American cars were larger, they got slapped with a heavier commodity tax in those days.

Mr. Bailey. Why was that done?

Mr. McCarthy. In those days, it was done, I would have to assume, to keep the larger cars out, because in those days the Japanese auto manufacturers were only producing smaller cars.

Mr. Bailey. It was done to protect the Japanese market.

Mr. McCarthy. In the days that existed, that would be my conclusion, sir.

Mr. Bailey. When did that expire?

Mr. McCarthy. Several years ago, as far as that discretionary aspect went; yes, sir.

Mr. Bailey. How long were they in existence?

Mr. McCarthy. Quite some time. I could not tell you exactly.

Mr. Bailey. OK. You said you had other experience.

Mr. McCarthy. The other experience would simply be that Japan has removed their tariffs for U.S.-produced automobiles shipped to their country; and, as a result, cars can enter into their market more freely. Certainly the products made in the United States prior to, say, 1979 by domestic manufacturers, tended to be larger products that were not readily marketable in Japan. Therefore, there was not much effort made to sell them in Japan.

Mr. Bailey. But you said something very important. You seemed to indicate that it was deliberately weighted toward the larger car. Why?

Mr. McCarthy. Well, I don't have them in front of me, but back in those days, if you read the regulations, you could almost see where, by engine size and various other categories, they were designed that the upper brackets would hit the American cars and just miss the Japanese car. This was at least several years ago.

Mr. Bailey. You realize you are doing me a great favor by testifying in this regard, because I had read, and I didn't have an exact source to cite, but you have direct experience with that?

Mr. McCarthy. I was familiar with the numbers at that time; yes.

Mr. Bailey. You were?

Mr. McCarthy. This was way back sometime ago, when we testified before the Ways and Means Committee. General Summerfield was our witness at that time, former Postmaster General. He was pointing out these very specific discrepancies.

Mr. Bailey. I have read of a multitude of different ones.

We have had testimony from our manufacturers, because they want to market there, but they are a little afraid to really take the Japanese system to task.

I don't know if they are or not; I just get that feeling, but I had read about all kinds of restrictions, and apparently they are changing, or hopefully they will change. There is more opportunity, at least at the present time, for an American manufacturer to try to market cars there. You feel that way?

Mr. McCarthy. There is no question that the American manufacturers' ability to market cars has increased greatly, and whether the barriers have been completely eliminated, or not, I cannot say; but they have been greatly reduced.

Mr. Bailey. Are the barriers still there to the larger cars?

Mr. McCarthy. I don't think they are.

Mr. Bailey. They have reduced the barriers to the larger cars now?

Mr. McCarthy. They have eliminated that discriminatory aspect of the commodity tax, and I don't think it would be any different to a larger car.

Mr. Bailey. You don't know when they were first put on?

Mr. McCarthy. The auto industry in Japan is fairly young, and I would assume that they were put on to protect the infant auto industry in Japan, when it started growing in the early 1950's. That is a reasonable guess.

Mr. Bailey. We had one witness who testified that for a while there had been an absolute exclusion to foreign sales in Japan. Is that accurate?

Mr. McCarthy. I am not aware of that.

Mr. Bailey. Do you know to the contrary?

Mr. McCarthy. I have never heard of it. I wasn't in the auto business at that time, and I really just don't know.

Mr. Bailey. You don't know at all?

I thank you at least for shoring up my remarks in that regard, because I know there have been; there are too many comments and too much testimony notwithstanding to the other side.

What other issues do you see as far as Japan? You mentioned other things.

Mr. McCarthy. The major problem is this: When a manufacturer has not participated in somebody's market, it is not easy to get in there.

The Japanese people had a loyalty to their product just as American people had a loyalty to American products, and it is not easy to crack a market like that unless something significant happens. In the United States, the Arab oil embargo was the significant event that overnight turned people to smaller cars.

If there would be some event in Japan which would turn them to larger cars, we would sell more cars.

Mr. Bailey. Was Detroit giving you automobiles that Americans wanted prior to the oil embargo?

Mr. McCarthy. Absolutely; yes. The American people were buying them in large numbers.

Mr. Greene. As I recall, and I may not be correct in this, but I am almost certain that I am, the first rebate that was instituted was on small vehicles.

They were not selling at the time.

Mr. Bailey. I was going to comment; I used to get Popular Science and read all that. Detroit did some experimentation during the sixties with small cars, and it did not meet with a lot of success, as I remember.

Every car they built, where there was a T-built 1955 that appealed to a certain group, that might be a sports-type car, eventually had to be upgraded or was upgraded to meet a consumer desire for more comfort and a larger and heavier car, and that goes a long way toward the point I tried to stress in these hearings, and that is that the American automobile manufacturer, and you people selling cars, were giving the consumer what the consumer wanted at that time, and it is not fair to blame you or the manufacturers for an Arab oil embargo that changed those choices overnight.

For 1 year, you could not get anybody to believe it, and they were still buying large cars, and then when it came in the second time, you saw that dramatic change, where people became convinced, and they bought a different car.

You did a heck of a job.

Mr. McCARTHY. Immediately after the oil embargo petroleum was available, and you could not sell the small cars, and the big cars started selling again.

Mr. BAILEY. What you call a large car today was really a medium-sized car many years ago.

One further question: We had a study referred to by two witnesses, the Harbridge study, on the cost of the individual car.

Mr. McCARTHY. I saw the numbers.

Mr. BAILEY. $3,200, or something, on average.

Mr. McCARTHY. That was their projection as to what the increased costs would be in the future. I am certain the price would go up. I don't think anybody can say exactly how much they would go up. You have certain basic assumptions you have to make in order to come up with a number, but there is no question that since there is a current demand for imported Japanese cars, and if you reduce those numbers, that the demand is even enhanced and people will pay more money, and the prices will go up.

Mr. BAILEY. You don't know how that study was conducted, and I would invite any of the witnesses to get that information on how it was conducted.

The Bureau of Labor Statistics indicate you are talking about a 3-percent rise in prices, and that $3,200 per car would be a dramatically greater increase than that, and, as a result of these changes, do you have any comments on that?

Mr. McCARTHY. I will give you a comment—we have had a lot of experience when there has been a shortage of cars. The increase would be very substantial, and I would not be at all surprised to see the increase around $3,000.

You take any hot model today——

Mr. BAILEY. That goes back to what you said originally, assuming a market where there is that much demand, and it is very hard to project that.

Mr. McCARTHY. It would be pretty easy to project the demand. The demand is there today. If you cut the numbers even to a third, the demand has got to be greater than it is today, and the premium people would pay for those cars is substantial.

Mr. BAILEY. What you are telling me is, as a final thing, it would be a substantial increase, but you just can't say how much.

Mr. McCARTHY. That would be our testimony; yes.

Mr. BAILEY. I am very grateful to you personally, particularly for your comments about the restrictions, because they were obviously governmentally applied. They had to do with engine size, you say, and that sort of thing, against American automobiles weighted against heavier cars. I don't know if they had a good rational reason in Japan.

I am not saying it was simply because they were anti-American, by the way, but, in any event, they were there, and that does contradict some of the testimony that we have had. I am also glad to hear that they have been—you say, to your knowledge—they have been eliminated or dropped, which is good, and hopefully maybe we can start selling over there.

We disagree on the final result, but I thank you very much for the excellent testimony.

Mr. McCarthy. Thank you very much.

Chairman Gibbons. As I recall, General Summerfield's testimony was in 1970.

Mr. McCarthy. The higher taxes on larger cars were still in effect at that time, and they came off shortly thereafter.

Chairman Gibbons. Thank you very much.

That concludes our testimony for today. We will reconvene tomorrow at 10 a.m.

We will convene in room 1100 of the Longworth Building.

Our witnesses tomorrow will be Paul Tippett, chairman of American Motors; Marvin Runyon, president and chief executive officer of Nissan; Tom Elliott, American Honda Motor Co.; James E. Harbour, president of Harbour and Associates; and representatives of the American Association of Port Authorities and the Port of Portland.

Thank you very much.

[Whereupon, at 5:20 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Wednesday, September 29, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

WEDNESDAY, SEPTEMBER 29, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. The Trade Subcommittee will come to order.

Our first witness this morning is from American Motors Corp., Mr. Paul W. Tippett.

We certainly appreciate your coming here. We know it was an inconvenience, and we do appreciate your coming here and giving us your views.

STATEMENT OF W. PAUL TIPPETT, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICAN MOTORS CORP.

Mr. Tippett. Thank you, Mr. Chairman. We are delighted to be here.

My name is Paul Tippett, chairman of American Motors Corp.

AMC is the fourth largest automotive manufacturer in the United States and ranks 155 in sales among the Fortune 500 companies.

I am pleased to comment on the trade position of the U.S. auto industry because of American Motors' unique relationship with Renault, the French automaker. In 1979, we acquired the right to manufacture Renault-designed passenger cars in the United States. Just last week, the first of these vehicles, appropriately named Renault Alliance, went on sale.

In this era of economic interdependence, no major company should expect to participate in a foreign market if its only strategy is to sell products and take the profits home, without investing in the host country.

No responsible company should expect a long-term presence in a foreign market if it enjoys unfair political and economic advantages that are denied to the host country's own basic industries. The impact of such unfair advantages on our basic industries is all too evident in the foreign-made products that line our shelves and in the long unemployment lines in our cities.

When I speak of unfair advantages, I am referring principally to one country—Japan. Japan is the only country to launch an attack on our basic industries as a matter of national policy. That attack and the failure of the Japanese to play by the same rules as the rest of the international business community are the basic reasons for this hearing today.

For 10 years we have been deluged with articles and TV documentaries about Japanese workers who are happy to work for lower wages than their American counterparts and who stand by their machines to sing the company anthem. Theory Z is fashionable, and a whole cottage industry of self-styled Japan experts has sprung up to advise us.

The fact is that Japan's success in the U.S. market stems largely from differences in the political treatment of industrial growth and foreign trade, not differences in culture or management techniques.

In the United States and most of the other major exporting countries, each company is left on its own to come up with a competitive strategy. The Governments involved largely confine their role to preserving competition and fair prices through antitrust laws and other regulations to prevent collusion.

In Japan, however, collusion is hardly rare. Many companies are encouraged to set production quotas, establish special supplier relationships, and fix prices. Such collusion plus an alliance of Government, manufacturing companies, and the banking system have enabled the Japanese to adopt a targeted industry strategy unique in international trade.

I have personally seen this strategy at work now in three different industries—electronics, sewing machines, and autos. The advantages provided by that strategy—not some of the mythical superiorities you have heard about—are what make the Japanese particularly tough in global markets.

The targeted industry strategy began at the end of World War II, when Japan's industrial base was in ruins. Certain basic industries with high export potential were identified and nurtured by the Government. These included steel, automobiles, and the then-infant electronics industry.

The targeted industries were nursed in a hothouse. At various stages, each industry benefited from special legislation and Government decrees.

As early as 1949, for example, controls were placed on the importation of foreign automobiles. A so-called temporary measures law was passed in 1956 to provide low-cost loans to the domestic automotive parts industry.

More recently, in 1978, a law was enacted that allows the Japanese Government to give Japanese electronics and machinery manufacturers every advantage it is able to muster. It allows companies to collude in setting production quotas, establishing supplier relationships, and setting prices. Any American businessman engaging in similar practices, of course, would be breaking our laws.

Their laws also permit the Government to fund massive R&D programs for the targeted industries and can exempt joint R&D projects from Japan's antitrust laws.

The Japanese Government gets some of the money for such R&D funding from the fact that the United States picks up much of the cost of Japan's military defense. In other words, the U.S. taxpayer is indirectly subsidizing Japanese commercial R&D.

The Japanese Government also provides accelerated depreciation and special tax credits for R&D. Tax reserves may be established for export sales.

In addition to aiding domestic industries, Japanese tax policy is used to keep out foreign competition. For example, a Japanese car exported to the United States is relieved of $900 in Japanese taxes, but a U.S. car imported into Japan picks up a Japanese tax burden of $1,100.

On top of this, there is the controlled exchange rate of the yen. It is estimated that Japanese automobile imports have a landed cost advantage of about $1,500 over U.S.-built cars because of the yen exchange rate alone.

I see this morning in the New York Times, the yen yesterday hit a 5-year low, 269 to the dollar.

Inflation in the United States has been far worse than in Japan, but this is not reflected in the yen exchange rate for the past decade. Most economists agree that if the yen had been allowed to strengthen to compensate for the disparity in the two countries' inflation rates, the yen exchange rate today would be in the range of 185 to the dollar. Instead, it is 269 to the dollar, 40 percent lower than its fair value.

The case is sometimes made that high U.S. interest rates are the reason for the undervalued yen. In the past year, however, the U.S. prime rate has declined from 21.5 percent to 13 percent; during the same period, the yen has not strengthened but rather further depreciated, from approximately 200 to the dollar to the current level of roughly 265. So you clearly cannot tie the yen's weakness to our interest rates.

The European Community has brought a formal charge against Japan under GATT based on the yen's artificially low value and the continued protection of the Japanese market against European imports. The International Monetary Fund may also take action.

While the Japanese deserve full credit for their productivity and innovation, it is the political and currency advantages I have just described that create the environment for such achievements.

Today, our own survival depends on whether we can muster the same will and unity that the Japanese did almost four decades ago, when the current targeted industry strategy was born. We can no longer afford to preach the virtues of free trade while the Japanese violate those principles in our own market.

Some Japanese companies have recently displayed the kind of attitude that should be the norm. For example, a Japanese steelmaker has moved to purchase controlling interest in Ford's steel operations and will produce some of its steel in this country. If the Japanese had not stepped in, 4,500 jobs would have been lost.

The voluntary import quota accepted by the Japanese Government last year was another positive step—and it is essential that the agreement be kept in force through 1983, as originally intended.

That import quota alone, however, falls far short of offsetting the unfair advantages I have been describing.

We must ask ourselves: How long can any of our basic industries—not just the auto industry—continue competing against the

Japanese if the Japanese are granted advantages not available in a free market?

I am not suggesting that the Congress legislate hothouse protection for the U.S. auto industry. Rather, we must make it clear to the Japanese that the days when they could get a free lunch are over.

How do we put the Japanese on notice? It would be preferable, of course, if the Japanese would voluntarily move to make action by our Government unnecessary. But I, for one, have given up on this possibility. The only thing they respond to is pressure.

Any pressure, however, must fairly balance the interests of the U.S. consumer, U.S. manufacturers and responsible foreign companies. In the case of the automobile industry, there are four separate points to be considered:

One, we must protect the American consumer's right to purchase a domestic or foreign vehicle. He should not be arbitrarily limited in the choice of products and should not be penalized by an artificially high price.

Two, we must preserve the U.S. manufacturer's right to use the lowest cost sources of materials and parts, including foreign sources, in order to remain economically competitive.

Three, we must not punish responsible foreign manufacturers by adopting requirements so strict as to force them to pull up stakes and leave the U.S. market.

Four, we must give special consideration to Canada, the only country in the world that has a bilateral automotive trade agreement with us.

I do not have a simple proposal that will resolve the dilemma, but I believe the bill before you, H.R. 5133, fails to meet any of these four criteria. Its extreme requirements, especially the 90 percent content standard, could limit consumer choice, raise prices and unnecessarily restrict domestic and foreign manufacturers alike. In the end, it could make the U.S. auto industry less competitive internationally. In short, it might jeopardize rather than protect American jobs.

American Motors, however, firmly supports the principle that manufacturers who participate in the U.S. market should provide jobs, pay taxes, and support the Nation's economy. This is the spirit behind Renault's Alliance with American Motors and behind other European manufacturers' commitments to produce in this country.

The basic concept of local content, itself, is not incompatible with the four principles I have listed, if applied judiciously. A fair local content formula could be derived using a combination of more graduated local standards and tariffs.

Many workable combinations could be proposed. My purpose today is not to suggest a specific piece of legislation, but let me offer just one example of what might be done.

For foreign manufacturers importing less than 100,000 cars and light trucks a year into the U.S. market, no local content would be required and the current tariff of 2.8 percent on cars and 25 percent on light trucks would not be changed. For companies importing 100,000 to 200,000 units a year, 25 percent local content would be required. Above 200,000 units, 50 percent local content would be required.

If the foreign manufacturer could not meet the 25 percent local content level by 1985, we could allow him to continue importing up to 200,000 units. However, in lieu of local content, make him pay a duty of 10.6 percent on passenger vehicles—the same level now imposed by the Common Market countries. This would provide an incentive to achieve the local content requirement. Anyone wanting to import more than 200,000 units would have to meet the 50 percent local content requirement by 1986—no exceptions.

In practice, this formula would protect both U.S. and foreign manufacturers' freedom to use a broad range of suppliers from many countries—thereby assuring a low-cost base—but at the same time assure that major importers made a contribution to our economy and tax base commensurate with the profits they earn here.

You have heard several arguments against any such action during the past week. None of them, in my judgment, will hold water. Let me go through four of the major ones.

First, you have heard that it would spark a trade war.

So—who are we going to war with?

All other industrialized countries in the Free World have perceived the threat of unfair competition for what it is—a concerted attack on their basic industries. Those countries have acted accordingly. The Common Market members, for example, have a tariff on automobiles more than three times higher than ours.

In addition, most European countries have imposed import quotas targeted specifically at the Japanese. In France, Japanese automobiles are limited to 3 percent of the total domestic market. In the United Kingdom, the quota is 10 percent, and in Italy it amounts to a flat 2,200 vehicles per year.

These measures clearly violate the spirit of GATT, but the Japanese have accepted them and continue to do business in Europe. If they can play on the Europeans' turf by the Europeans' rules, why shouldn't they do the same on our turf? That is all anyone in the automotive, steel, electronics or any other industry should get—a level playing field that still preserves the right of choice for the American consumer.

The Japanese surplus in trade with the United States last year was $16 billion, according to the U.S. Department of commerce. This year, it will probably exceed $20 billion. Are they going to war with us? Of course not. They are not about to stop trading because of tariffs or moderate local content requirements designed to ensure they provide at least some American jobs, and pay some American taxes.

So much for trade wars.

Second, you have heard it argued that any form of local content and higher tariffs would result in higher prices for the American consumer and would transfer income from consumers and exporters to auto workers. This would not be the case under a moderate formula such as I described.

In this country, the market—not quotas, tariffs or local content—determines the price for the consumer. The Japanese have had to pay a tariff of 25 percent on light trucks for nearly 3 years, and prices have not gone up abnormally. Interestingly, however, the value of the yen began to fall at about the time the tariff was raised, so Japanese profits did not suffer.

Similarly, the voluntary quota on Japanese cars has had no significant impact on the price of cars in this country—contrary to what the doomsayers forecast when it was adopted. Pricing to consumers for the 1982 model year was well below the inflation rate and many 1983 model prices have actually come down.

Nor will the U.S. consumer pay for the capital required to build plants in this country—the Japanese will. To remain competitive in this country, they will accept those costs as part of the price of doing business, as do American manufacturers. And both consumers and exporters will benefit from the resulting generation of new jobs and fair trade in this country.

Third, it has been argued that local content would be a crutch for the U.S. automobile industry, allowing it to avoid the adjustments necessary to become competitive.

Well, we have made adjustments and the U.S. auto industry is now competitive in product with everyone and in cost with every country except one—Japan. The principal reason, not the only reason, the Japanese have a major cost edge is not that they are inherently more capable, productive or innovative, but rather that they have the strategic and currency advantages I have talked about this morning.

Fourth, you have been told that any action would violate U.S. trade obligations and prevent a worldwide economic recovery. You have seen how our European partners view this risk. We also have an obligation to our trading partners as well as ourselves to preserve our basic industries.

Without them, our economy simply cannot grow, and our trading partners will in turn suffer. I believe that giving our basic industries a fair chance against the Japanese is the first step toward global recovery. In other words, if our basic industries don't get healthy, there probably won't be a full recovery.

Secretary Baldrige admitted before this committee last week that the vague promises obtained from the Japanese during 18 months of negotiations have not been matched with tangible changes in Japanese trade policy. As the Secretary noted, "Without a thorough-going change in [Japanese] private and public attitudes at all levels, real progress is far off."

I agree with the Secretary's observation. They have been slow-walking us to death. But the Japanese attitude won't change unless they receive a clear and strong signal that we are serious.

We can no longer afford the luxury of merely shaking our finger and lecturing the Japanese on the virtues of free trade as if they were an unruly pupil and we were the teacher. The Japanese graduated from the classroom to the real world long ago, and it is high time we did the same.

That is the end of my prepared remarks, Mr. Chairman.

Chairman GIBBONS. Thank you, sir.

As I said before, we certainly appreciate you coming here today, and I appreciate your opposition to this bill.

You mention the yen-dollar ratio, and you cite this morning's New York Times.

Do you have any evidence that the Japanese have been manipulating the currency ratio?

Mr. TIPPETT. There is no evidence available to us, Mr. Chairman, of course, because we have no way to gather such evidence.

When, however, over a continued period of time, the currency defies the basic laws of economics, I believe it warrants a thorough investigation by the experts in this matter.

I would urge this committee, for example, to request from the Treasury Department an explanation of why the yen has dropped so dramatically over the past 2½ years, in spite of evidence to the contrary that it should, in fact, strengthen.

There is one piece of specific counsel I would respectfully offer.

The yen is the only major international currency that is not freely traded. In other words, if I want to go to Japan and borrow some yen, that may or may not be permitted.

Internal borrowing in Japan for the yen averaged a rate of about 8 percent interest over the past 2 years.

If that were available to American Motors, we would be over there borrowing it tomorrow. However, we are not permitted to do that.

The Bank of Japan restricts international borrowing of the yen to approximately $70 million a month, or less than $1 billion a year, which is really peanuts.

Why do they restrict international borrowing of the yen? Why, in fact, is it not a truly traded international currency?

If the yen were available at 8 percent, there would be a rush to borrow it. Interest rates would go up in Japan. The yen would strengthen, and they would not have sufficiently available internal yen to loan at 8 percent.

Therefore, what do they do? They say, we are going to control it and not let it be freely traded, as is the dollar, French franc, and so forth, and making the yen a truly international currency would be the first step toward solving the problem rather than letting them restrict its availability, and, therefore, controlling its value.

Chairman GIBBONS. Well, we asked the Treasury back in June or July to please respond to the yen/dollar value ratio question, and we also asked the General Accounting Office later to please check into it.

Every witness that has raised this issue, most of them have been mystified as to the ratio.

I do not know why the yen is in such condition. In the same article that you quote, right below it, it says that the U.S. dollar is soaring in Europe, against all of those economies, including the French economy.

Mr. TIPPETT. It has, but just recently.

Two years ago, the dollar was worth 4 francs, and now it is worth 7 for events that occurred in France as much as anything else.

It seems to me the experts in this area, the people who have the resources to make such an investigation do owe the business community and the Congress a reasoned explanation of why, in fact, the yen has appeared to behave contrary to the basic laws of economics, and when, in fact, such behavior gives great impetus to the

Japanese national business strategy, to restrict imports and encourage exports.

If it didn't have such a happy coincidence of benefit for Japan, everyone would be less suspicious, but when, for example, it is coincidental with the import duty on light trucks and a restriction on the number of Japanese cars that can be imported in this country, when it happens so that the Japanese manufacturers retain or improve their profits on lower volumes of vehicles, somebody ought to be looking at that to investigate it thoroughly.

Chairman GIBBONS. I can't imagine all the countries of the world trying to lower the value of their currency versus our dollar.

The dollar has gained against the Canadian dollar by about 25 percent and against the yen, even in that same range, even more.

The dollar has gained against French currency by about 40 percent and against the German currency by about 25 percent.

It seems like to me it would take an international conspiracy of great magnitude to ever produce that result.

Unless, as bad as things are here in this country, they are even worse in other places, that is the only logical explanation that anybody can give.

Mr. TIPPETT. I think that is true; perhaps in every case but Japan.

The Canadian inflation rate, which generally determines the currency's value, has been substantially higher than the U.S. inflation rate, and the French has, too, but the Japanese inflation rate has been substantially lower.

Chairman GIBBONS. The Japanese are not big personal consumers. They apparently save 20 percent or 18 percent of what they earn.

Those are unheard-of personal savings rates as compared to any other economies.

Mr. TIPPETT. They do have strong incentives for that.

For example, up to $15,000 savings are tax-free.

There are no taxes on dividends and capital gains in the Japanese stock market for individual consumers.

Chairman GIBBONS. That is one policy they follow, and I don't think it would hurt us to emulate them, but I certainly don't wish to in many other areas.

Mr. Bailey.

Mr. BAILEY. I wish you would have been around yesterday. It was a tough day for me.

The statement you have made here today is absolutely the most comprehensive and the most honest we have had presented to the subcommittee, not because I agree with just about all that you say, and I happen to disagree with the conclusion, but if only because I think we do need a 2-by-4 out there to teach some lessons, which is one of the things that you made reference to, that idea.

It is rather because you have really addressed the reasons why this legislation is before this subcommittee. We have had a picture painted here; in fact, yesterday, a gentlemen testified, Mr. Rehm, I think his name is, from a law firm in Washington, obviously a very knowledgeable fellow, but I was a little concerned about some of the conclusions he reached.

Let me tell you some of the ideas presented before the subcommittee yesterday by some of the witnesses. One of the major inconsistencies, incidentally, was that Detroit had pursued a world car policy and manufacturing abroad, and that kind of thing in general.

That was inconsistent with the fact that nobody had done much manufacturing in Japan. He said it was just that the Detroit companies were big, fat, lazy, and they were so big and fat and lazy because of their American market, they really did not care to do business in Japan.

If you sat down and looked at it, that was completely inaccurate, because they have been very active in trying to do things all over the world, but ironically, not in Japan.

I started to wonder why. It is a very obvious point that occurred to me.

I wish to thank you for placing on the record the comments you have about the protectionist attitude, particularly in the infant stages of the automobile Japanese industry, because we sometimes get so caught up with disagreeing with a domestic policy choice like this, that we start to castigate the United States. And then we start to defend Japanese policy, or at least pretend that they don't follow certain domestic policies there which are highly protectionist, albeit in a sometimes circuitous way.

The industrial policy, a term I liked used by Mr. Fox, from the National Association of Manufacturers, and what you have called the political or targeted approach here is something that needs to be put on the public record, and I am extremely grateful to you for it.

If you piece together some of the testimony before the committee, it backs up the comments that you have made about the yen, because practically everyone who has testified on the availability of credit in Japan has said that it is very, very difficult to borrow there.

As a matter of fact, one of the witnesses testified that you can get one, two, or three loans of a certain amount. They have to be very small, or whatever. I don't know the details. I really don't, but it does not take too many smarts to piece together the line of testimony that has been coming before this committee over time, and it also does not take too much to realize that the reason this legislation is being brought before us is that there is an angry reaction in this country, and there has been an angry reaction worldwide to people feeling victimized.

It has been my contention that the Japanese should wake up, and I would like to ask your permission in that connection; I would like to take your statement and put a cover letter to it, and I would like to check into the possibility of mailing it to each member of the Japanese parliament with a very polite and courteous letter explaining to them that people are becoming angry worldwide because their practices are threatening that world order.

I don't know if that puts you in the soup or not.

Mr. TIPPETT. Mr. Bailey, permission granted.

Mr BAILEY. I would like to do that because they need to understand the comprehensive nature of what they are doing. I don't want the audience to get the idea that we are hostile to them or that somebody is afraid of them. Their way of doing things would lead to incredible chaos among nations, and there would be chaos, trade war, violence, maybe physical violence.

Would you expound on why people are not going to Japan to manufacture American automobiles for the Japanese market? We were told yesterday by several witnesses that that market is open, the Japanese market is open, that it is either my imagination or our imagination or whatever, but it is just that people don't try to do business.

Why does an American businessman want to do business all over the world and not in Japan, why? It doesn't make sense to me. You guys don't like Japan, the geography, the climate, the people?

It doesn't make sense to me.

Mr. **Tippett**. First, let me put, just to establish our credentials in this area, in terms of being interested in overseas business, let me say that American Motors, for example, is the 46th largest exporter in the United States, of all the companies in this country.

Second, if you take exports—yes, sir, excuse me?

Mr. **Bailey**. If I could possibly, this is very important here, because there has been a continuing debate running in the committee about how open that Japanese market is.

Yesterday, we had testimony that contradicted the contention that many witnesses have made, and I have come to the conclusion, sadly, that it is really not a very open environment in which to invest and market and work in if you are a foreigner.

There seemed to be a lot of prejudice there. One witness said he thought it was cultural. That is nonsense.

You can sit down and look at government policy over the years, and it is very clear that that is absolute nonsense, but in the interests of courtesy, could you comment on what your experiences have been?

Mr. **Tippett**. Yes, I would be happy to.

As I said, I think our credentials are pretty good in terms of seeking international business opportunities. We are the 46th largest exporter in the United States and if you take our export sales as a percentage of our total sales, we are the 22d most export-oriented company in this country.

We have plants all over the world and we export from our U.S. base here.

There are several problems currently with selling things in Japan and one is, without being excessively persistent on this subject, one problem is the 260 yen to the dollar. It makes our products so high-priced in Japan it is virtually impossible to sell them at a profit competitive with Japanese products.

That is very convenient, because if all the trade barriers and the so-called official restrictions to imports were lifted in Japan, the yen alone would make it very difficult to export.

Mr. **Bailey**. That is interesting. You say those barriers may be part of this currency problem.

Mr. **Tippett**. If there were no barriers at all, and we just drove the cars from the boats right to the dealership without anybody saying hello to us, we would still have a heck of a problem, because we couldn't maky any money on them with the 260 yen to the dollar.

That advantage hurts us all over the world. We compete with the Japanese in Australia, the Middle East, and they beat our brains in with a 40-percent kind of margin advantage which is really what it amounts to.

The second problem with Japan in terms of building, actually going into a factory or manufacturing operation, is in the automobile business, obviously, a retail distribution network is critical.

Land is so expensive in Japan, and the investment required is so excessive that the only practical way to do it is to engage in a joint venture with an existing Japanese company, and distribute your products through their network.

We are attempting to do this now with jeeps, using their network.

The obvious limits on your opportunity, when you are at the mercy of the Japanese distribution network, make major investments in manufacturing facilities highly suspect. In our situation, and other automobile manufacturers, the opportunities for major profit in Japan, given the size of the investment required, just aren't there.

You are dependent on a Japanese manufacturer for a distribution network, and there is no practical way to build a factory there unless it is a joint venture.

When I was at Singer, with plants all over the world, Singer tried to go it alone in Japan, and although it was successful in every other market, it was unsuccessful in Japan.

Mr. **Bailey**. Why?

Mr. **Tippett**. It is very difficult to operate there without Japanese representation.

Mr. **Bailey**. Government help or what?

Mr. **Tippett**. Government help. Japanese investment and equity so that things seem to happen, if there is a Japanese equity participation in the venture, that don't happen when there are no such investments.

It is a very difficult thing to track, and all I can say is, Ford and General Motors have massive investments in Europe and in many, many other countries, Brazil, Venezuela, Colombia and so forth.

They have none in Japan, and it can't be that they have suddenly become anti-export, or anti-international business. The restrictions there are just too difficult in many respects. It is not a good gamble for the investment dollars.

Mr. **Bailey**. Mr. Chairman, I wonder, instead of taking more time, I know I overdo it and you are awfully kind to me. Perhaps I could come back later with a couple of questions.

Chairman **Gibbons**. Certainly.

Mr. **Brodhead**. I want to join with Mr. Bailey in thanking you for your statement. We get a lot of people come talk to us and we have had a lot of people talk to us about this particular issue, but I must say that your statement is the clearest and the most forthright that we have heard before this committee.

We thank you for it. I think we are all agreed on all sides of this issue, that what we are after is a level playing field and you used that expression in your testimony. As I understand what you are saying, you are saying that some action by our Government, some combination of content requirement with tariffs is necessary in order to make the playing field level? Is that correct?

Mr. **Tippett**. Yes, sir, it is my judgment that the Japanese will do nothing else unless we pressure them to do something. If I were in their shoes, I would do nothing unless I was pressured.

Mr. **Brodhead**. That is exactly right. The situation at the current moment is very favorable to them, and they are very kind and willing to talk with us at great length about the problems, but very little action has been forthcoming. Simply, they would not be faithful to their obligations to their stockholders if they did anything, because the current situation is really the most favorable to them.

The problem with our international oil policy was that we were playing chess while the Arab nations were playing Monopoly, they used to say, and that was one of the reasons that Henry Kissinger and our other Secretaries of State were good chess players but that wasn't the game that was being played.

I wonder if you would agree that we are talking about a free market and the values of competition and trying to keep the American market as open as possible and other countries—particularly Japan—are not playing that way.

They are playing a different game.

They are playing a game where they have a concerted strategy to provide every advantage to their domestic companies who wish to export and export particularly to the United States.

And as a result of a combination of a vast number of actions that they have taken, they have a huge advantage in our market.

I say naively and I wonder if you would agree, we think our system is better and we think our principles make more sense and we will play the game this way. Thus far, we are losing?

Mr. **Tippett**. No question about that, sir.

We have heard a great deal about the fact that our problems with Japan are generated by greater Japanese worker loyalty, the differential in wage rates, productivity, that sort of thing. Some of those that have been problems in the past are being corrected, but even if they are corrected, in total, we would still have disadvantages versus the Japanese for the reasons I tried to describe in the first part of my testimony.

Monopoly situations exist in Japan, collusion in markets, prices, low government loans, manipulation of the exchange rate, many things that give them basic strategic advantages that we cannot match.

What are our options? Are we going to change the antitrust laws in this country? Of course, we are not. Are we going to have the Congress grant business low-cost loans? Of course not.

Are we going to manipulate the dollar? Of course not.

All the things they do, when you examine ways in which you could get the playing field level, you say is not either a political or an economic possibility.

Reluctantly and with great disappointment, by the way, no one likes to propose these kinds of things, least of all me, there is only one way left. The only way is to get them over here, where all of those things or most of those things don't apply.

In other words, where the export subsidies and the currency advantages and the collusion on suppliers and all those things don't apply to the same degree in this country.

That is the only solution I have found and I have arrived at it reluctantly but it is not just a problem in the automobile business, but the Senate Foreign Relations Committee is now hearing testimony on the subject of the impact of the Japanese in the high technology business, using exactly the same strategy where they absolve the targeted industries in their country from antitrust laws and fund massive low-cost research and development loans.

We cannot compete forever under those circumstances, and I don't care if our wage rates were $4 an hour. The only thing I can think of is to require some form of participation in this country so that those advantages are not as operable.

Mr. BRODHEAD. The American automobile manufacturers have done this, that is, if we seek to be involved in the British, French, or German market and we are, American manufacturers are, and they have done that.

Mr. TIPPETT. And European manufacturers have come over here.

Mr. BRODHEAD. Right, the way we have participated in those markets is not by seeking to have the Government, our Government give them undue advantages but to go over there and slug it out with them, and they have had a great deal of success.

In fact, Ford Motor Co. has been very successful, and they have made big profits by employing local people in those countries, dealing with local suppliers, and becoming good corporate citizens in those countries.

Mr. TIPPETT. The question is, Why don't the Japanese do the same thing?

Mr. BRODHEAD. Yes, why don't the Japanese do that in the United States?

The answer we seem to be getting is because their government gives them huge advantages to doing business the way they are doing it in this country, that other governments in the world would not allow that, and the United States of America allows it, so we become the target country.

On the question of the differential in wages, there has been a great deal of discussion here before this committee in these hearings about the difference in wages between the auto workers in Japan and in the United States versus the auto workers in the United States, I mean.

There has been a great deal of exaggeration as to how much our auto workers are paid and with respect to how little the Japanese auto workers are paid.

From all I know, the Japanese auto workers enjoy perhaps not quite the equal of the standard of living of the American auto workers, but they do enjoy a reasonable standard of living.

Isn't it true that with the 40-percent undervaluation of the yen, that that would be more than half of the difference between the way, in other words, when we compute what the American automobile worker earns versus what the Japanese auto worker earns, the artifically low value placed on the yen is a huge percentage of that difference, more than half?

Mr. TIPPETT. Yes, sir, correct.

Mr. **Brodhead.** To say that the American auto worker is paid the total labor costs of the American worker, auto worker, is somewhere around $23, $24 an hour, versus $12 in Japan, if the yen were valued at what is a reasonable, appropriate rate, that that difference in wages would be very narrow indeed?

Mr. **Tippett.** Looking at the total cost of the vehicle, I think that the difference in the yen-dollar relationship and where it is, regarding where it should be, would more than wipe out every labor cost advantage the Japanese have.

Mr. **Brodhead.** More than wipe it out. Just simply that one adjustment alone?

Mr. **Tippett.** Correct.

Mr. **Brodhead.** Then, of course, there is the question of the very substantial obstacles that are placed in the way of bringing American or any other foreign automobiles into Japan versus the subsidies the Japanese give for exports. So just because of the tax advantage alone more than offsets the cost of transportation, so that in fact the Japanese car is substantially cheaper in Japan and then it is after it has been loaded on a boat and shipped over to the United States and shipped several thousand miles, it is still, the car is less expensive in real economic value, it is less expensive in the United States than it is in Japan.

And because of the tax breaks that they provide?

Mr. **Tippett.** That is correct. It is not just in the automobile business, but there are a large number of Japanese-made products, the last place to buy them at a good price is Japan.

Mr. **Brodhead.** If we are talking in these hearings about a large number of factors that go into the reasons why a substantial segment of the American market prefers the Japanese car to the American car, then those two factors alone, the depreciation of the yen and the export subsidies more than wipe out the difference in wages, and more than wipe out the difference in price. So if the Japanese Government were behaving the same way our Government is behaving, not providing these advantages to the Japanese automobile industry, they would not have the market that they have in this country.

Is that correct?

Mr. **Tippett.** Yes, sir, that is correct. I would be more than happy to take on the Japanese with no excuses whatever, if they were building cars in this country. We have been told that they are better managers and their workers are more loyal and all that stuff, but if the playing field is even, and we don't beat them then, shame on us, but I would be perfectly willing to take them on in any market where we are operating on the same basis.

Mr. **Brodhead.** I think we have really gotten down to the root of this problem and it strikes me that our Government has really, if anything, placed obstacles in the way of the success of the American automobile industry, both domestically and abroad, whereas the Japanese Government has done any number of things to create artificial advantages for their auto export industry.

Is that correct?

Mr. **Tippett.** Yes, sir.

Mr. **Brodhead.** Thank you very much, Mr. Chairman.

Thank you, Mr. Tippett.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Tippett, for your excellent testimony. I do have some questions, but I would like to pick up on some statements from the previous question. We have been talking about export subsidies. Perhaps you would describe what those subsidies are for me. I was unaware that there was a subsidy problem there, and in violation of the GATT agreement.

Mr. **Tippett**. I am not an expert on all the techniques.

I know low-cost loans are available to Japanese for export programs, especially depreciation credits on machinery installation is available, if that machinery is destined to produce products for export; for example, I believe some of the machinery can be written off in 2 years, and those kinds of things that are in place to encourage exports by the Japanese and are not in place to the same degree in this country.

Those are two with which I am familiar.

Mr. **Frenzel**. Looking at some of our hearings from last year, and those special depreciation allowances do not appear in some of the material that was given to us.

Our record indicates, from the State Department in general, depreciation allowances received by producers in each country are fairly comparable and do not seem to be a source of competitive advantage.

Corporate income is lower in Japan, 35 versus 45, and there is no investment tax credit in Japan as there is in the United States.

If properly accepted, if we go around calling things subsidies, we ought to do it in the trading sense, and if you are prepared to make a complaint, you ought to make the accusation.

Most countries in the world use an excise tax, a VAT tax, which is remitted at the border.

The GATT rules were set up to do that sort of thing and it is legal. The United States does not do it, but that is our choice, and at least in the sense of the trading rules, I am not aware that can really be defined as a subsidy.

Mr. **Tippett**. As I say, I would be happy to supply you with some examples of subsidies applied to available Japanese companies for export programs.

I will drop you a letter with that and supply the members of the committee with the same document.

Mr. **Frenzel**. I would be glad to have it, but again, we are looking for the level playing field. We have done some R&D credits and some protection and nurturing of the aerospace industries ourselves and we are talking about choices.

When other countries decide to do them, they are awful, and simply because we didn't decide to do them.

When we want to penalize somebody for doing something which we could have done but don't want to do, we are getting a little tough in a world where we all got to live together, and we want to trade with one another.

Mr. **Tippett**. The question is whether or not we want to do it. If we chose to do some of the things that the Japanese have done, modify our antitrust laws and provide low-cost loans for research and development, that is another matter.

That is not a political possibility in this country, and we have to talk about what we can do, not what we would like to do.

Mr. **Frenzel**. My problem is, because the rest of the world won't act like we do?

Mr. **Tippett**. No, it is Japan. Let's be clear about that.

Mr. **Frenzel**. Because they won't do what we want them to do, we are going to impose something on them. We would like the whole world to be full of nice democrats in a republic like ourselves.

Some of them are doing what they want to do. Let me get back to the yen, and if you want to add some more on this later, I would be delighted to have you do so.

You talked about restrictions on borrowing of yen. Isn't it true that the restrictions that Japan has put on borrowing, particularly for capital moving offshore would tend to push the yen the other way?

Mr. **Tippett**. It might push the yen the other way in the very short term, but in the longer term, creating an international currency that is freely traded, it would tend to stabilize the yen.

Mr. **Frenzel**. What do you think the UAW would do when it started to go down in the short term?

Mr. **Tippett**. I really don't know.

I still think we have to solve some of these problems in the long term. We have been talking about this issue in this country for 10 years, and nothing has been done versus the Japanese, and it is about time we did something or they did something, more importantly.

Mr. **Frenzel**. OK, on page 3 of your testimony, you said the Japanese Government gets some of the money for R&D funding, but the fact is that the United States picks up most of the cost of Japan's military expense.

We are indirectly subsidizing the Japanese commercial R&D. I agree with that statement in general. However, the United States is doing it as a matter of national policy. Are we then to penalize the Japanese because of something that we are doing of our own free will?

Mr. **Tippett**. Possibly not.

I guess I question that policy as a citizen. I think at the same time, we have to recognize those facts, however, when we are determining whether or not our basic industries can compete with the Japanese on a fair basis.

When the Japanese contribute to their own national defense, about eight-tenths of 1 percent of their gross national product, equivalent as a percentage to what Nepal spends on defense, versus 6 percent in the United States, that is a tremendous advantage they have. Whether or not that national policy is correct, I think frankly in dealing with Japan, that is one of our problems.

There are so many major issues facing an administration regarding Japan, usually defense treaties, Far East foreign policy, and so forth, they put trade and the health of some of our basic industries perhaps lower than they should in evaluating how much pressure to put on that country.

Mr. **Frenzel**. All of the countries in the world are playing a trade game and we are playing a geopolitical game. We put some interest in trying to enhance our own exports, and put a little money where our sentiments are alleged to be, we are going to be behind.

I agree with you 100 percent.

On page 6, you stipulate four criteria that have to be considered. Can any local content bill satisfy those four criteria wholly? I don't disagree with your criteria, but I am confused by the fact that you think somehow we can weave a local content bill in there that will preserve some of those?

Mr. TIPPETT. In my judgment a moderate local content bill could.

The problem with the bill before your committee is it takes local content to 90 percent and that does not leave much room for seeking low-cost sources of supplies, parts. It doesn't give auto manufacturers any options.

A more moderate bill, let's say 50 percent, would still give plenty of room for low-cost sourcing, maintain your cost competition with other world manufacturers but require some participation in this economy by major importers. A 50-percent level would not drive up consumers' prices, which is one of the criteria that I have outlined.

All it would do is reduce Japanese margins, not drive up consumer prices at some reasonable content level.

Mr. FRENZEL. Can you meet the 90 percent in your line?

Mr. TIPPETT. As applied to us, the bill would be about 60 percent or 50 percent. We hit about 70, 75 percent. If we had to comply, of course, we would. We currently comply with the provisions of the bill as it is before you, so we are not arguing against the bill because it hurts us.

Mr. FRENZEL. Let me suggest that it might. Supposing you are integrating in the airline foreign-produced components, and you should, and the price of the frank firms, or wherever you are purchasing, you could get knocked out of the box in 1 year?

Mr. TIPPETT. Possible, of course.

Ninety percent to me would be excessively restrictive. The only thing that I have been able to come up with or anyone else to eliminate some of this what we call the nonlevel playing field is local content in a moderate way.

Certainly, excessive tariffs or quotas restricts the choice of the customers and is not in the interest of the country.

Mr. FRENZEL. I notice you are asking that the 25 percent duty on light trucks not be changed. Isn't that the highest in the world?

Mr. TIPPETT. It may be. At this point, we have trucks being made in this country and it probably is not as essential as it was 3 years ago.

Most of those small light trucks are now being made in this country in order to meet the CAFE requirements.

The Japanese are less strong in the truck business than they are in the car business. For a reasonable tradeoff, I would be willing to consider that, but until we get some concessions with the Japanese, we ought not to give up anything.

The talk about the bill before you automatically being vetoed takes whatever pressure exists from its presence away. We have got to keep pressure on the Japanese, because that is the only thing they understand.

Mr. **Frenzel**. We got to keep pressure on the Japanese for a variety of reasons, but I am a little resistent to the idea that we tell them they have to do business just like we do. That is the point where I get a little nervous.

You say here, if they exceed their local content limitation, you will make them pay a little higher duty. That lets them buy out of the American labor market.

Mr. **Tippett**. Only in the area of 100,000 and 200,000. There could be a circumstance where a manufacturer is selling 125,000 units in this country and they don't quite feel that that volume justifies a major manufacturing investment until they hit 200, well, that would permit them to stay in the market, pay a little extra in duty and bide their time until they hit the volume required, say, 200,000.

It is only between that range. We are trying to make sure we didn't restrict the choice of the American customer, just like under 100,000, there shouldn't be any restrictions at all.

Mr. **Frenzel**. You say on page 8, that the European quotas on Japanese vehicles clearly violate the spirit of the GATT, but the Japanese accept them. Why shouldn't they do the same?

Didn't we impose a quota on Japan last year which we euphemistically call a voluntary restraint? That is no different from what we did to screw up the international market?

Mr. **Tippett**. It was a voluntarily quota, and established with the intent of restricting the Japanese to 18 percent and they are now at 28 percent, as of a month or two ago. I don't think they find that excessively onerous, going to over 20 percent of the market from 18.

Mr. **Frenzel**. It was a hard unit quota.

Mr. **Tippett**. It was a clear intent to stay about 18 percent, and that is what we think it will be. There was a considerable discussion of that issue at that time and it was not written into the agreement but their market shares increased significantly.

Therefore, I don't think they find that requirement excessively onerous, as I say.

Mr. **Frenzel**. Are the Japanese going to go to war with us? Of course not. They want to sell to us. Countries will find ways to buy and sell, no matter how we distort the rules under which they do so.

I am much less worried about the Japanese in this problem than I am about third markets, particularly the EC, when we put on the voluntary restraints, Canada demanded the same. We will get them in other third markets.

It seems to me this kind of a philosophy, as one of our witnesses told us yesterday, may mean the Americans are giving up the world market. Do you have that feeling?

Mr. **Tippett**. No, sir, I do not.

If this problem were prevalent among many countries, I would have to be forced to agree with your conclusion, but we have no problem shipping, if we choose to, products from the United States to the Common Market.

We have no problem accepting products from the Common Market. Canada does have a local content requirement, the Automotive Products Trade Act. They have a very strong local content requirement in addition to the voluntary quota they felt obliged to talk to the Japanese about. So the only problem we seem to have is with one country, and when you talk about us decimating all the world trade agreements, that is the part I don't understand, because there is only one country that seems to be a problem in this.

Mr. FRENZEL. Only one that is a problem to you, sir.

Mr. TIPPETT. I am talking about the automobile business, right. I have been asked to testify on the effects of the automobile business. It is just not automobiles, but steel, electronics, and other things.

Mr. FRENZEL. The problem I see, the other end and not at this end, and at page 9, you said that contrary to the doomsayers, the price of cars didn't go up in this country.

I think that the other domestic auto makers have showed us that prices increased very slightly, less than anticipated, after the volunteer restraints were put into operation.

However, we have had testimony from the people that sell the cars that the price of imported cars, particularly Japanese, escalated very rapidly and did so because having a small number of units, they wanted to sell better, higher-priced units and did so, and we have the record rather heavily spread from yesterday.

Would you comment whether you are restricting your comments to American car prices or to imports?

Mr. TIPPETT. I am addressing both American car prices and imports.

For example, the 1982 pricing, when the 1982 models were priced, the general forecast for inflation in this country was about 8 percent, and that was by the Department of Commerce. With 8 percent inflation rate facing everybody, Toyota priced, 6.4; Nissan, 5 percent; and Mazda, 3.7 percent.

U.S. manufacturers priced roughly 5 to 6 percent. On top of those pricing actions, should I say, taken away were all the rebate activities that went on during the 1982 model year, averaging 4 percent approximately.

The real price to the customer went down significantly.

Mr. FRENZEL. I am talking about what the car cost.

Mr. TIPPETT. Sir, what the car cost is what the pricing was 1982 versus 1981 minus the rebates, and to give you another example, Nissan introduced their newest vehicle, called the Nissan Sentra at a very aggressive price, $4,995, and it was a 1982 model, and their 1983 Nissan Sentra price was just announced, $4,995, the same price.

They have raised prices on their upscale, more expensive models, but the cars where the price is a significant element in the purchase consideration, the ones competing with the new models of U.S. manufacturers, they have been very cautious in pricing.

They have shown a great deal of restraint on prices with the exception of some of the upscale vehicles.

Mr. FRENZEL. We want them to keep you honest and you to keep them honest. We want the lowest cost automobiles we can find.

Mr. TIPPETT. The U.S. manufacturers did not raise prices this year. The question is because of some of the advantages they have over the long-term, whether or not we can make enough money pricing that way to continue investing and developing new products when they have a 40-percent advantage in the yen, for example.

We have to have sufficient profits to pay our workers and invest in new products.

Mr. **Frenzel**. The 40-percent advantage is your estimate.

Somebody has to show us how that thing gets manipulated before we can accept that. We all believe that the yen is undervalued, but it is very difficult to prove. Your testimony has been very interesting.

Mr. **Vander Jagt**. It is a pleasure to have you. Your statement was excellent and I appreciate your appearance here.

On page 3, you mentioned as early as 1949, for example, controls were placed on the importation of foreign automobiles into Japan. Do you know the nature of those controls, or how effective they were?

Mr. **Tippett**. Extremely effective at that time. Those controls have been relaxed to some degree. To what degree is a matter of considerable debate in this country but again, I can furnish you with the details of that.

We really put that in our testimony mostly as a piece of perspective, historical perspective on the trends since that period. Just after the war, the Japanese had to do a great many things to encourage their economic development, and that is understandable.

Nobody is arguing with what they might have had to do in 1949, but when you see that historical perspective and the bases on which they have built, that was really the purpose that we included that statement for.

I would be happy to supply you with the information we have on that subject.

Mr. **Vander Jagt**. That would be very helpful, because there has been a bit of discussion as to what those controls were.

You said earlier that it takes a lot of pressure off the Japanese when the White House announces that it will veto this legislation. I was under the impression that the White House has scrupulously avoided announcing that they would veto this legislation.

There has been a lot of speculation about it.

Mr. **Tippett**. Perhaps I was incorrect. Maybe it was the talk and speculation. I hope they have not done so.

I will certainly say that Secretary Baldrige and Trade Ambassador Brock have taken a great deal of interest in this subject. They are very difficult to hurry up and I am quite sympathetic to their efforts.

I hope I didn't say the White House made the decision. The rumors and discussions of decisions is what I was reflecting on.

The Japanese could tend to read that the wrong way.

Mr. **Vander Jagt**. That is fine. One last question, you feel we have to keep pressure on the Japanese to get that even playing field and you oppose this legislation for the reasons that you set forth and .you suggest an alternative. What about making the import controls discretionary with the executive, to be imposed only if they did not find a cooperation amongst our trading partners, would that not strengthen the negotiating hand?

Mr. **Tippett**. No question that it would, sir, but my only concern about that would be whether or not in the face of what is concerned to be more, what might be considered to be more cosmic issues with the Japanese, whether the Executive Branch would take the same stiff position that the Congress might want to take on such matters.

When you are dealing with a foreign government, of course, this is not the only point at issue with the Japanese, many other things, mutual defense agreements and so forth, and giving the executive the opportunity to relax these might be a problem depending on what other issues were facing them.

Mr. Vander Jagt. Thank you very much for your excellent testimony.

Chairman Gibbons. Mr. Pease.

Mr. Pease. Thank you, Mr. Chairman.

Thank you, Mr. Tippett. I enjoyed reading your testimony. How many automobiles or vehicles does American Motors produce in the United States each year?

Mr. Tippett. About 400,000.

Mr. Pease. What would the quantity for your largest single model? Your largest selling single model?

Mr. Tippett. 100,000.

Mr. Pease. 100,000.

Yesterday, a witness appeared before us attributing practically the whole success of the Japanese was economies of scale, saying the Japanese have concentrated their production in Japan and they achieve enormous quantities, or enormous savings based on scale, and that is why they are able to undersell American cars.

I thought he rather overemphasized the economies of scale argument.

He mentioned Volkswagen as falling below, I think their projected goal of 100 or 200,000 cars and suggested that is why they are in trouble with their American operation.

Do you agree, or to what degree at all, if any, do you agree with the scale arguments?

Mr. Tippett. One of the advantages the Japanese enjoy because of their exclusive, almost exclusive, manufacturing policy in Japan is a larger economic of scale than they would otherwise enjoy, and they use that quite effectively.

They will get together the manufacturers and the government and agree to buy certain parts for a product or a vehicle from supplier X in Japan, thereby guaranteeing supplier a huge volume, and at a reasonable price presumably, and that permits the supplier to buy the latest equipment, get high production runs and so forth, and get very good quality and at low prices.

No question about the fact that that is an advantage.

To me, the question is whether or not reasonable economies of scale can be achieved by producing elsewhere.

For example, Ford has four to five plants in Europe. General Motors has three or four plants in Europe. They apparently feel that reasonable economies of scale can be obtained with plants in Europe, for example, without having to build all the products in the United States.

So, yes, it is an advantage for the Japanese.

The question is whether we are penalizing them unfairly to say you need to build a plant or two in the United States, and my answer is no, when Toyota sells 500,000 or 600,000 units in this country, that is plenty of units to justify a plant, one plant or even two.

Mr. **Pease**. You mentioned the Japanese are more inclined to collusion than we are among their manufacturers, and you mentioned the alliance of government manufacturing companies in the banking system, which a lot of other people have referred to also.

Apparently that is their system. We have strong antitrust laws which would prevent collusion, and we have had traditionally in this country a somewhat adversarial relationship among government, unions, and companies.

Can we compete against Japan or any other country that has that closer relationship among the major actors on the stage with out system, or do we have to change our system?

Mr. **Tippett**. Well, I think, first, there is no question about the fact that the Japanese operate under unique principles in the business environment. They have what they call Keiretsu, or groups of companies that are mutually allied. They have a trading company, and the top four Keiretsu in Japan are so powerful, they control about 50 percent of the total manufacturing sector.

That is their system. I do not believe we could change the way we live in this country, nor should we. Our system is different. I do believe, however, when only one country in the world, as I stated at the outset of my testimony, operates in this fashion, it puts everyone else at a significant disadvantage.

Almost every other industrialized country, the government sets the laws, letting businesses develop their own strategy and may the best man win.

When basic industries are attacked by a Keiretsu system with the support of the government, I think that that has to be taken into account, if you consider the health of the basic industries of these countries important.

If you do not, fine, but see, their targeted industries philosophy applies to basic industry.

They are not talking about aluminum baseball bats, although that has been the subject of considerable discussion. They are talking about steel, electronics, and things we need to remain a first-rate economic power.

The Congress is rightfully concerned whether or not their system is a serious threat to our basic industries, and in my judgment, it is.

Mr. **Pease**. Could you contrast the situation in the United States and Japan vis-a-vis Europe? Obviously, we know there must be a working relationship there between government and the nationalized banks and the manufacturing corporations, and why is it different with Europe?

Mr. **Tippett**. First, it is not unusual for the European governments to consider their basic industries as critical to their economic success. Volkswagen is owned approximately 45 percent by the Federal or the State government in which they operate. British Leland is subsidized, and that is by the government of the United Kingdom.

I can tell you that Renault, and I can't speak about Fiat; they operate as a basic independent company.

They happen to have the government as their principal stockholder, because that is a French tradition.

There are other companies in Europe under the same circumstances, but they make money and lose money like any other company. I can't speak for Fiat.

Because they are Renault, or because they are in a unique industry, they don't get the same collusive advantages that the Japanese do.

Peugeot is a private company that operates in France in competition with Renault.

They don't get any of the advantages that they do in Japan, operating with MITI.

Mr. PEASE. We have heard a lot about this underevaluation of the yen, and we have not been able to figure out how it comes about.

In your testimony you suggest that that is not accidental; that somehow or other the Japanese Government deliberately undervalues the yen.

Do you have any notion at all of specifically how they go about doing that?

Mr. TIPPETT. Hopefully the testimony does not charge them directly with conspiring to do so, but it is certainly a happy coincidence for them, and when the economic facts would lead you to believe just the opposite should occur, it naturally makes you somewhat suspicious.

I mentioned earlier that the yen is not a freely traded currency in the world which, of course, for the third largest exporter in the world, you would expect the yen to be freely traded. It is controlled by the Bank of Japan. That is one way it could be controlled, and, as I said, we don't fancy ourselves as having the resources or staff to check out all the international currency issues that might be present, but we would certainly recommend that the committee ask the Treasury Department to explain why, in fact, it has weakened so dramatically when other economic evidence would suggest that that would not normally have been the case.

Mr. PEASE. I think that is an excellent suggestion.

If the underevaluation is a genuine happy coincidence, as you use that term, then I guess we can't bludgeon the Japanese into deliberately changing that, but we certainly ought to make sure that there isn't something more than coincidence involved.

Thank you, sir.

Chairman GIBBONS. Mr. Tippett, do you think there is any connection between the fact that near-bankrupt France owns Renault and Citroen, as well as the control of your company, has anything to do with the fact that they limit the importation of Japanese cars into their country to 3 percent? Is it just a coincidence?

The French franc is tumbling so fast that they have almost exhausted all of their reserves in trying to prop up a highly nationalized economy.

They have socialized virtually every industry that has anything to do with productivity.

Do you think there is any connection with the fact that they limit importation to approximately 3 percent and the fact that they are in financial difficulty? Is there any causal relationship at all?

Mr. TIPPETT. Mr. Chairman, you obviously think there is.

Chairman GIBBONS. Yes, sir; no doubt in my mind.

Mr. TIPPETT. There are not many people who would call General de Gaulle a socialist.

Chairman GIBBONS. They own the other companies outright, and they control your company. Should we really follow the French?

Mr. TIPPETT. Let me try to answer your question. The restrictions on Japanese imports into France predate the current administration in France by 15 to 16 years at least. Those were operative under Gaullist government, Giscard d'Estaing, so forth, and it applied when the franc was 4-to-1.

Second, I think to suggest that because Renault owns 46 percent of American Motors, we should follow them to bankruptcy is not logical. Renault has been an extremely successful competitor, worldwide. They have been successful in Germany, England, and successful in many markets other than France. Citroen, by the way, is part of Peugeot, not Renault, and they are going to make it.

French industry has in many areas been in a leadership position.

Of course, some of the actions of the socialist government have not contributed to the confidence in the franc, but suggesting that because Renault operates in France, that it will go bankrupt, or we will, is hard to follow, frankly.

Chairman GIBBONS. Good. A year ago, the Gallup poll conducted a study on consumer perceptions of goods. Industry, chief executives rated worse in the quality of goods and services—the American automobile manufacturers. They got the lowest rating from large, medium, and small firms. Small firms said their products were poor quality by 62 percent; medium firms 51 percent; and the heads of large firms by 48 percent.

The next lowest score outside of the automobile business was the home repair and maintenance business, and they got 6 percent, 5 percent, and 7 percent ratings, respectively.

Could that have anything to do with the fact that while foreign import penetration has increased by only 400,000 units, consumption of domestically produced automobiles has dropped by 4½ million units?

Mr. TIPPETT. Of course, it could have something to do with it.

All research of that type—whether or not chief executives are the most appropriate to interview.

Chairman GIBBONS. They are usually chief executives because they are smart.

You would not disagree with that?

Mr. TIPPETT. Of course not.

Whether or not they drive the same cars the average consumer drives is another question.

The point is real. We suffer from a real image problem.

All research is basically a look in the rear-view mirror, and since 1978 or 1979, we have made dramatic steps forward in product quality, the kind of imagery that would turn that research around, not overnight.

You don't lose a reputation overnight, and you don't regain it overnight. Our products in this industry are fully competitive with any manufacturer in the world, including the Japanese. I would be willing to put our new Renault Alliance up against any Japanese product, in every phase.

We do suffer from an image problem.

As I say, all market researchers look in the rear-view mirror, not out through the windshield, and we will regain the reputation we should have in that area.

Chairman **Gibbons**. Mr. Bailey?

Mr. **Bailey**. Mr. Tippett, did you and I conspire on your statement or any of your testimony here today?

Mr. **Tippett**. No, sir, that is against the law, and I certainly would not want to do that.

Mr. **Bailey**. I wasn't talking about that.

Mr. **Tippett**. No; the first time we met was today.

Mr. **Bailey**. I am convinced you are going to go to heaven.

Mr. **Tippett**. You are the only person who thinks that.

Mr. **Bailey**. I am sure the good Lord will agree.

Are you familiar with the Houdaille case at all?

Mr. **Tippett**. We are examining that petition now, and it is approximately 600 pages long. And our people are going through it right now, and I am interested in what they are alleging.

Mr. **Bailey**. I hope you will study it very, very closely.

It is an absolutely perfect outline that would reinforce points that you have made here today. I think it is something that we can all learn from in this country and hopefully the Japanese will profit from it, because, as they see what happens with some of the points made in those petitions, I can't wait until the press stumbles on it, and I hope that they will, and the whole world will profit.

I wanted to go back to a point Mr. Frenzel made, because he really put his finger on the thing.

The question is one of systems and conflict, and I really believe that. Governmental systems in conflict. I really think that is what we are talking about with this legislation and the political environment in which it exists.

Mr. Frenzel made some comments about liking to see a world full of democratic republics, and I guess I would, too.

Take the American model, the relationship between the American Government and American business and labor, et cetera.

Take that model.

Look at the Japanese model, and the relationship there between labor, Government, and industry in Japan.

Can the world afford to do business on the Japanese example?

It is not an issue of socialism. It is an issue of State capitalism almost where you structure your market in a way of really going after foreign markets.

You protect your own somewhat, and you target other countries, as a matter of national policy, and you pick them apart.

You plan and pick them apart.

Your comments on American basic industries or basic industries worldwide are so cogent that I sat up here and chuckled, after serving on the Armed Services Committee, where we studied this problem.

What happens if everyone in the world does what the Japanese do?

Mr. **Tippett**. You would have the ultimate protectionist system. We would be in a peck of trouble, because if you had everybody doing what the Japanese were doing, it would be highly incestuous, and it would be a problem with free trade, and it would not work.

Mr. **Bailey**. What if we do everything the way we do it?

Mr. **Tippett**. With some exceptions, the U.S. model is not that far from the basic European models, the other developed countries in the world—West Germany, France, Italy, Canada—and we tend to operate in much the same way.

I tried to describe in my testimony, which is viewing the basic role of the Government as being a force designed to keep everybody honest, simply put, establish the antitrust laws, maintain a reasonably stable currency and let every company design its own strategy to be competitive.

That is the American system. I find that generally prevalent in the European markets. If that were not the case, major American companies would not put the kinds of investments in Europe as they have done.

Mr. **Bailey**. Looking at the thing in reasonable or relative terms, you would say that as far as world trade is concerned, that the American model represents a workable, fairer system of making it possible for independent economic actors—businessmen and even government-owned business entities—to do business in a world trade sense, without causing the systems as nations to collide and compete to the point where one feels victimized, and the other is taking advantage?

Mr. **Tippett**. Yes, sir, I think that is correct.

Mr. **Bailey**. Look at those two things—that Japanese system, ours, and the rest of the world's basically.

The responsibility for maintaining political freedoms, the responsibilities of defense, et cetera, that we have largely shouldered.

Mr. Frenzel did an excellent job, and he raised the issue of our thinking in geopolitical terms, and maybe not thinking enough in trade terms. I really don't think that is correct. I disagree with him to a small degree.

I think we have been thinking pretty much in a trade sense as part of that geopolitical thinking, but we have not had a choice.

Would you comment on the fact that the whole world seems to be pretty much reacting to some of these target policies. You have some experience with France, and why does the whole world single out Japan? Are they afraid of the Japanese ability?

I am not.

Mr. **Tippett**. Again, given a reasonable and overworked analogy, in a reasonably level playing field, people are not concerned about it. That does not exist currently.

Mr. **Bailey**. Are you saying the Japanese policy, in terms of international responsibility, the Japanese policy is doing harm to the free world in general?

Mr. **Tippett**. I am not sure I would go that far, but certainly they have devised a system in which their own national self-interest is clearly No. 1, and have focused on that role and priority to a greater degree than almost anyone else.

I would say that. Whether or not they are doing harm or intentionally, I am sure they are not intentionally doing harm to the rest of the world, but they are following their strategy and doing it effectively, and if I was in their shoes, I would keep doing it as long as people let me do it.

Mr. BAILEY. That is where I disagree with you, and I say the only way this problem is ever going to get solved is the Japanese have to grow up and look at things in terms of responsibility. That is a painful thing to do. That means you may have to give up some edges, and give here and fight there, because really in terms of competitive practice, they are the ones that are playing with this idea of monopoly. It is horribly dangerous to world stability, and they are the only ones that can resolve it.

I am firmly convinced of that, or they will find themselves completely isolated.

The European reaction has spread, and to spread to a country like this, with our philosophy, just shows how dangerous it can be. The Japanese have to learn and understand and open their eyes and see that their industrial policy is a danger to free world stability in many ways.

I really believe it is.

Mr. TIPPETT. I think there are many, many thoughtful Japanese who agree with you, and have stated so publicly; that many of them are concerned that Japan will be ultimately isolated as essentially a prosperous orphan.

Mr. BAILEY. That is exactly correct. I have materials in my office, Japanese commentators, on that very issue. That is exactly what they say; that the Japanese have got to play a little fairer, and they have just got to understand at least the world concept of fairness has to change.

Let me ask you this. You made a statement that is one of the most profound that have been made here; you said, no matter what we did, if we go back to square 1, we cannot compete against the Japanese national policies that exist now.

Mr. TIPPETT. What I tried to say was that even if the practices which are alleged to have caused us the trouble today in the automobile business, differential in wage rates, productivity, even if all those things were eliminated in one stroke, the strategic advantages they would retain would still give us tremendous difficulties, because they, to me—the strategic national policy of the Japanese Government is the most difficult thing to combat, and they would still retain substantial competitive advantages, even if they solved all the other problems.

Mr. BAILEY. I agree. There is absolutely no way, if we think for 1 minute that we can go back to prevoluntary restraints, or whatever. If we go back to the beginning on square 1, it simply is not going to work or not going to solve the problems.

We are going to end up with investment-short basic industries in this country, and they are never going to be able to attract investor confidence because of confronting that policy, because of that ever-present Japanese policy. They will never attract the kind of confidence necessary to invest and build in that long-term investment industry.

That Houdaille matter, I hope you will study it closely and comment on it publicly.

Chairman GIBBONS. Thank you, Mr. Tippett.

Our next witness is Mr. James. E. Harbour, president of Harbour and Associates.

Then we will take up the witness from Nissan Motors.

Welcome. You may proceed as you wish.

STATEMENT OF JAMES E. HARBOUR, PRESIDENT, HARBOUR & ASSOCIATES, INC.

Mr. **Harbour**. Thank you, Mr. Chairman.

I have given you a copy of the brief remarks that I have prepared, and I welcome the opportunity to address you today on the very important subject of the U.S. automobile industry.

I speak as a former member of the automotive industry with 28 years' experience as a manufacturing executive in both the financial and engineering disciplines.

Chairman **Gibbons**. Excuse me, Mr. Harbour. I notice this room will be preempted at 1:30 for a few minutes.

I wish to ask the other members of the committee, what would be your pleasure? Would you like to go on or recess?

Mr. **Frenzel**. Keep going.

Chairman **Gibbons**. Go right ahead, Mr. Harbour.

We will keep going.

Mr. **Harbour**. Thank you, Mr. Chairman.

When I speak, I speak of my years as well. In addition, I am not employed as a consultant to any auto company anywhere in the world.

Let me briefly highlight the vastness of this industry and its related employment. In 1978, this industry built 14.8 million vehicles and employed some 2.8 million workers, of which 950,000 are prime manufacturers; 620,000 are parts suppliers; 225,000 raw materials suppliers; 225,000 nonproductive materials suppliers; 300,000 transportation—rail/truck; and 480,000 machine tool industry.

Many of these jobs are not in the traditional auto areas such as Detroit, but spread throughout the country. Also, because the auto industry is so extensive, many of the lost jobs are not attributed to the decline in the auto sector.

Yesterday, I was in Jackson, Mich., where we finished a study for the county of Jackson, which is experiencing 35 percent total manufacturing unemployment.

As far as automobile workers go, I would estimate that at present 900,000 of these auto and supplier workers are unemployed and their chance for recall is zero to none.

The domestic automotive industry is currently in deep trouble and the outlook for its survival is very questionable. The industry's problems are not the result of: a lack of fuel-efficient cars; a lack of front-wheel drive cars; and high interest rates.

The industry's problems are more the result of: high quality and competitively produced and priced import cars; declining U.S. manufacturing productivity; redundant work rules, management systems; and general economic depression.

Granted, better economic conditions, lower interest rates and new products will help. However, they are only a small part of the answer.

The Japanese currently manufacture a small passenger car in Japan at least $2,500 less than U.S. manufacturers, and this has substantially reduced the U.S. industry's ability to compete. The Japanese competitive advantage is not the result of better physical technology. Our detailed studies indicate that physical technology accounts for less than 4 percent of the difference, and this includes the often touted use of robots in Japan.

There is absolutely no amount of money that the U.S. auto industry can throw at this problem to buy new technology in an attempt to solve it or leap-frog the competition. The Japanese, after copying U.S. technology, have simply applied infinitely better management systems, including: defect-prevention quality systems; zero inventory and production systems; employment of the total workforce to identify quality and productivity systems; improved facilities utilization; and streamlined organizations.

In Japan, to build high quality vehicles, they will stop that assembly line twice a day and give everybody mass relief.

In the United States, we are not quite as smart. We hire 300 extra people for the plant, and if I were a relief man, I would have to relieve nine people and hopefully build the same level of quality as the original guy.

I firmly believe that the U.S. auto industry will take 3 to 5 years to apply the management technology required to return the industry to a world competitive position. Our Government must recognize that the automotive industry as you once knew it, will no longer be a dominant force in the U.S economy, if something is not done to stem the tide of import Japanese cars and trucks, while the U.S. industry is in transition.

I am not sure if local content is the answer in the United States. However, it is used in Japan when it is viewed as advantageous. Many of the requirements for coproduction of military hardware in Japan—a program similar in effect to local content—are used to achieve the national goal of development of high technology industries.

Coproduction is as inefficient in Japan as local content is in the United States, but it is consciously used as a tacking device to achieve other objectives. Likewise, local content might be a device to protect U.S. industry and the domestic manufacturing base in this critical time of transition.

If the automotive industry continues to lose market share, there will be substantial deteriorations in the U.S. industrial base and an erosion of the industrial Midwest.

The size of the auto industry makes it very visible in the Government and the public view; however, this industry's noncompetitiveness is only symptomatic of many of the U.S. hard-good industries.

Some 15 or 20 years ago, the United States was the world leader in developing and exporting high technology products such as aircraft, cars and trucks, computers, electronics, machine tools, and farm equipment, to only name a few. The reality of the current situation is that within 10 to 15 years, without any U.S. industrial policy and with stagnant productivity, the U.S. industrial base will be so eroded that the chief U.S. exports will be farm products, services and free enterprise ideology.

Finally, the bottom line of this industrial erosion is unemployed workers who want employment but must unwillingly collect unemployment benefits, food stamps, welfare, and relief payments. It is time we honestly recognize that we have seriously underestimated the scope of world competition and have overestimated our past industrial strength, and we are fast becoming a second-rate manufacturing nation.

That concludes my statement. I know the time is not available for you, but if some time were available someday, I could come to Washington and show you what I mean by productivity in detail, and it would take an hour or so, if your time was ever available.

Chairman GIBBONS. That is an attractive offer, and we certainly will try to find an opportunity to listen to you on that.

Mr. BAILEY. Thank you, Mr. Chairman.

I will be very brief, but would like to request the opportunity to come back and rehabilitate the witness.

I have one question for you. Did you and I get together on this statement, or talk about this testimony before you got here?

Mr. HARBOUR. Unfortunately, no, we did not.

Mr. BAILEY. I couldn't say it any better than you have.

I would invite your attention to a report done by the Armed Services Committee, concentrated on the Nation's defense industrial base. I was a member of that panel, and it did go to the issue of the general industrial base in the United States and practices followed in other countries. I would secondly bring to your attention and hope you will check out and read and do some talking about the petition in the Houdaille case, dealing with the machine and tool industry, which is a classic case when we are talking about protection of advancement of marketing practices at home and in other countries.

Well, I think it would result in some good responses from our country.

I wish to thank you very much.

Mr. HARBOUR. Congressman, I would like to add this:

When I was at Chrysler Corp., and while you are on defense industries, when we tooled up your new battle tank in the east side of Detroit, we bought many Japanese machine tools to tool that tank for you; so, if you wanted to expand it, it will be a little tough.

Mr. BAILEY. When we tried to buy the glass with the necessary translucency so it could be laminated for firing ports, it took over 6 months to find an American manufacturer. Everybody has themselves convinced in this country you will get into some nuclear 30-day scenario of trading. That is simplistic stupidity that the left has been fostering on this country for many years, but it is utter nonsense and not very realistic.

To go out there and warm up and gear up this Nation's defense industrial base, it could possibly bankrupt us. If we think we had problems during the Second World War, getting that thing going, the problems we face today, it would be incredible, because we no longer have the technology we did then.

Again, I am really grateful for your remarks. You have hit at the real reasons why this legislation is before this committee, not just because of selfish people, but because of national concern.

I thank you very much.

Mr. **Brodhead**. Mr. Harbour, as a Detroiter, I, of course, followed your remarks, and your statements have been printed in some length in the Detroit papers over the last couple of years, and I must say, as an observer of the industry, you seem to have a great deal of insight, a great deal of persistence, and have made, in my view, a very important contribution toward helping all of us understand what is going on with this vital and important industry.

You put your finger here in your paper on the problem that concerns many of us, and that is, our industrial base, as you say, is eroding, and in the auto industry eroding very rapidly.

It seems to me that the machine-tool capacity, the steel capacity, assembly and production capacity is eroding very rapidly, and plants are closing, and they are not going to be reopened.

The work forces are being dispersed, and capable people are being employed in other industries.

This could have a detrimental impact in the long term on our economic security and our military security, and do you share that view?

Mr. **Harbour**. Congressman, I am in your district, but there very definitely is a pattern being followed here.

Let me give you a few specific examples, and I follow some other industries, too.

In the last 3 years, we, as a country, have closed 30 major steel works, an average of 1 million tons apiece. That is not just because of the weight or downsizing of cars. We would have lost nowhere near that, but here is an industry, when I studied it, that has a technological problem. It is behind in technology; contrary to the automobile industry, which is not behind at all.

Yet we have $6 or $7 billion every year for acquisitions, but who has the first billion dollars to modernize a steel mill?

I don't know where all our steel is going to come. When I was at Chrysler and building the old M-60 tank, there was one foundry in the United States to make the tank hull—one.

Now, we weld the tank hull together for the new tank, but, even so, the steel supply is one steel mill.

Mr. **Brodhead**. It strikes me in that connection that this big fight that has just gone on, we have all been reading about it—the four-way fight between Bendix and Martin Marietta, United Technologies, and Allied Corp.; that hundreds of millions, perhaps even billions, were spent in that fight. I am not aware that out of that one job is going to be produced.

As you point out, if that money had been spent on improving our productive capacity, maybe the country would be better off.

Mr. **Harbour**. I think you are right, and here is the case where one of your major defense contractors is now $900 million in debt.

Let me take a very simple little component.

All cars, all trucks, even tanks, require an enormous number of fasteners to put them together, fasteners being rivets, bolts, nuts, screws.

This country buys 80 percent of its standard fasteners and 50 percent of its special fasteners, and nobody gives a damn. We cannot assemble a car, truck in this country without fasteners from Japan.

Mr. **Brodhead**. What if we were faced with a situation such as we were faced with in 1940, 1941, and 1942, where we had to gear up our industry in order to defend the free world? We have all heard a lot about how bad it was then in terms of our ability to gear up, to meet the industrial challenge of the Second World War. It strikes me that we are in worst shape today than we were then, and I mean our ability to respond is not even what it was then in terms of having to depend on foreign sources of supply, not having the domestic production capability, a substantial share of which is in the auto and truck industry; is it not?

Mr. **Harbour**. That is correct. I have a simple answer to that. If you want a long-term war, and I was Russia, I would blockade Japan, and I would eat you alive.

Believe me, we are now buying 35 percent of our machine tools in this country, not all from Japan. We are buying a major portion of our steel. We are buying fasteners, and some of the very key elements that require the buildup of conventional military hardware or cars and trucks, whatever, and if we are going to be in a long-term war, I would blockade that island, and I would have you where I want you.

Mr. **Brodhead**. One of the arguments in favor of taking some kind of action to try to keep this industry healthy is to preserve the base, the military base, and the economic base that is or has always been thought to be the backbone of our military strength.

We may be a paper tiger, may be in the process of becoming a paper tiger militarily, because we don't have the domestic capacity to produce the things that were needed—that would be needed to face military challenges. Is that correct?

Mr. **Harbour**. That is correct, Congressman, but we should not divert our attention from something else.

Remember, what I have tried to say today is that we have a management problem in this country, and it will take this industry, plus a lot of others, some 3 to 5 years to turn around now that the challenge is recognized.

I am scared to death that this industry, plus many others—machine, tools, forklift, trucks, and others—are not going to have the time to turn around.

I am knowledgeable enough about the Japanese, and I guarantee you that if something is not done, their product plans call for them to have 50 percent of our car market by 1990, and they will gracefully give GM 33, and Ford 12, and Chrysler 5, and forget all the rest.

If we don't have the time to install the management technology as opposed to physical technology, you can kiss this industry goodbye, as you once knew it.

Mr. **Brodhead**. Thank you very much, Mr. Harbour.

Chairman **Gibbons**. You know, I really seriously worry about the management of the industry, an industry that allowed itself to be priced so completely out of everybody's market. Steel and autos—the steelworkers are paid more than any other workers in the United States by about 80 percent now, and the autoworkers by about 70 percent. Does that tell you anything?

Mr. **Harbour**. Yes; it does, Mr. Chairman, and I can guarantee you this right now, of the $2,500 that they can land a car in this

United States with, there is about $500 to $600 of a labor cost difference, but, at the same time, they spend $500 to ship that car in, pay duty and get it ready in the port, so when you deduct those two together, you still have a $2,400 management difference; so you can forget wage rates and other factors.

We still have a productivity problem.

Chairman GIBBONS. It is not that we have bought so many foreign cars.

The dropoff in American cars has been 4½-million units since the peak of 1978. The increase in foreign imports has only been 10 percent of that, so, 9-to-1, they voted against the American car because of its quality and its price. That is 9-to-1, and that is a pretty good voting ratio.

Mr. HARBOUR. You hit that on the head, Mr. Chairman. People buy hard goods today after they determine the right product.

The next factor is quality. You said that before when I was sitting in the back of the room, and you just said it again. They have got a system of quality. We are, in effect, in the process now of changing our system around from what is commonly called defect detection to defect prevention.

They have made major inroads in our market not only in cars, stereos, watches, and cameras, also, and machine tools, because they supply a superior quality product——

Chairman GIBBONS. Quality control is just a management problem?

Mr. HARBOUR. Absolutely.

Chairman GIBBONS. We have the highest paid management and the highest paid workers in the world asking all the rest of us to support them while they recover? Isn't that it?

Mr. HARBOUR. I think that is your statement.

Chairman GIBBONS. Well, what else is it, then?

Mr. HARBOUR. Mr. Chairman, I admit it is a management problem.

Several of the companies admit it, themselves.

The only question right now, Mr. Chairman, is, are they going to have time to change it around now that they recognize it?

I work for some very major defense contractors. This same problem extends to them. We are not only talking about the automobile industry. It extends to almost every hard goods industry in the United States, Mr. Chairman.

Chairman GIBBONS. I am just talking; I hate to quote the bosses, because they may be prejudiced, but this Gallup poll last year, heads of small industry voted against automobiles by 62 percent, U.S.-manufactured automobiles.

The heads of medium-sized industries, 51 percent, and large firms, 48 percent.

The Postal Service was close to it, other than home repairs. They didn't even come close. Home repairs only got 6 and 7 percent adverse votes. Postal Service got 5 and 6 percent.

Mr. HARBOUR. We are talking about quality. Talking about the subject you have brought up, how about the quality of delivery of a letter from the Post Office? For me to get quality in your postal system, I have to pay $8 to buy that quality. I used to get 1-day delivery for 10 cents 5 years ago; so the quality of the mail system has also gone to hell. It is a management problem, be it management in Government or industry.

Chairman **Gibbons**. I am not arguing with you at all. Thank you.

Mr. **Bailey**. I want you to know that the Postal Service is not our industry, my friend. We turned it over to you, the private sector.

There are a lot of folks that think it ought to be back under Government management, because there are some people who believe that there are a few things that the Government can do, and there are a few things that the Government is supposed to do, and that the role and function of Government is not to dry up and blow away.

I happen to be one that thinks there is a middle ground.

We have firmly established from pros and cons and everybody on every side of this legislation, that wage rates and labor compensation in the United States of America is comparable to Europe, and we have also firmly established that a $12 an hour equivalent, where the yen is valued at what is supposed to be valued at, supposedly, that we are talking about a wage rate of approximately $17 in Japan, and from one of the strongest critics of this legislation, the point is on the record and was made very, very loud and clear, that those differences are simply irrelevant and meaningless when it comes to talking about the competitiveness of the product.

Second, I think there are some difficulties in this system, and I will now find myself in your corner, and I happen to think that the domestic policy was at the root of that evil. American management responds to what environment it is given to operate in, and I think the Government ought to take the major blame for the problems with the steel industry, mining, railroads, and it is going to be in aeronautics, pulp and paper, automobiles, glass. You want me to continue? They are all hard goods, and I am not going to blame American management for them.

It takes time to make a conversion; that industry is in the process of retooling and adapting. They did not create the problem which caused the difficulty. Essentially, the change in oil prices, and I think somebody needs to compliment and pay some compliments to an American management and an American labor who have done a tremendous job of responding to what they perceive as a challenge.

Here is my problem: The causes of this thing, and the portent for the future. You were in here for the testimony of the previous witness?

Mr. **Harbour**. Yes, sir.

Mr. **Bailey**. I see the problem on a much larger scale. I am very much aware of the defense problems that you have mentioned and studied them very, very closely, and you are 1,000 percent right, and I compliment you for bringing those issues up.

Incidentally, if you talk about raw materials, manganese, you know we are importing it, and we have deposits in the United States.

We import all our cobalt. We have cobalt in the United States.

Mr. **Harbour**. I didn't know that.

Mr. **Bailey**. Missouri and Idaho, to wit.

It would take 6 to 7 years to develop those facilities after intensive capital investment in order to get them to be producing mines.

Are you aware, and have you read about Soviet policy in Africa and Zaire, a good example of cornering resource markets?

Mr. **Harbour.** I was not aware of that.

Mr. **Bailey.** Add that to your research, because you are doing a tremendous service.

What would you do to complain about this problem, shake up management? Do you provide them with the capital? They got the incentives, the competition. Do you want to do things the way the Japanese do, maybe establish a war-planning board?

What would you do, and recommend that we do?

Mr. **Harbour.** Let me say, Mr. Tippett brought it up very vividly and most people don't understand it.

We are not dealing with the Toyota Co. or Honda or Nissan. You are dealing with what is called a great big trading company. For example, Mitsui, as far as I am concerned the largest corporation in the world with annual turnover of $180 billion.

Mr. **Bailey.** Are you familiar with the situation, the cases involving Mitsui now?

Mr. **Harbour.** No, sir.

Mr. **Bailey.** They won't get much attention from this Government.

Mr. **Harbour.** The point of it is, what they have done here is they have an absolute planning strategy of what markets they are going after and how.

Understand, today, the automobile industry over there is very independent. Almost debt free, Toyota is debt free, has billions in the bank, and they are not really under the control of MITI or anybody else any more.

I know enough of these automobile companies. A lot of our problems, Congressman, will be solved by becoming competitive. We can talk about it all we want. American people are going to buy the best quality, lowest priced product, and they are not underpricing their products.

As the yen went from 210 to 260, they never touched the prices. Now, because of limitations on how many they can ship in, they are shipping in Nissan Maximas, Toyota Cressidas, $17,000 cars.

A lot of this problem is, we can handle ourselves by being competitive. We can't control the exchange rate, the yen exchange rate and all the other factors.

Mr. **Bailey.** You can't control Japanese industrial policy and compete with being targeted in a market abroad. Capital investment and reinvestment in this industry is not the best place for me to put my money, is that right?

Mr. **Harbour.** That is correct.

Mr. **Bailey.** That is why I brought up the point about mergers and acquisitions, and diversifications, because I think we have to understand the motivations that cause the American businessmen to act the way they do, and why the American system operates the way it does.

I also would mention diversifications and that kind of thing. United States Steel was criticized in the Marathon situation. They were not diversifications of capital as a matter of fact.

Second, I also found out that the acquisition was financed through borrowing on the equity involved, and I think that we have to be careful with those kinds of criticism.

There is no way to defend it. It is not accurate or not correct. It is not to say you can't criticize it. It is not to say that honest opinions might say it is too high, but it is just not correct. It doesn't solve the problem.

The question is, because we don't have an industrial policy and you are an investor out there, are you going to invest in a cobalt mine in Missouri when you don't know what in the heck Government policy is going to be 10 or 15 or 20 years down the road or you don't know if you will get your feet cut out from under you from abroad?

I can run right down the list, and you can add it to your list, and nuclear energy, the turbine business, including geothermal. I can talk about any single basic major industry or feed stock primary industry and they are going to have the same problem in the United States, and they will not have that problem abroad.

I have a lot of ideas that I won't bore you with what to do about them. I would rather see people around the world do things our way or maybe all these pressure will lead to a world order where free nations will truly combine their economic, and intellectual power, and try to build a world without nuclear weapons, and where people can be free.

That is my political dream, but it can't be done if nations are to be on collision courses, and definitely policies that victimize their free enterprise neighbors.

That is why there is this reaction in America, and it is our domestic policy and practice in this country, too.

I don't mean to say, Mr. Frenzel mentioned earlier, do things the way we do them, no, but there has to be some modicum of national responsibility and not goals by free world nations that tie in with our free world objectives and that cannot be done where a nation's governmental policy is to victimize your markets. Mr. Tippett was most eloquent in his reference to that difficulty.

We owe you a debt for bringing in these national defense issues as well.

The tuned armor things, the new tank, the turbine engines, maybe it is not a good idea to talk on the record because of some of the sensitivities of those technologies to imported raw materials and machine parts.

Any confrontation in Europe, even in a nuclear situation, is going to depend greatly upon the mobility and freedom of armor to move, and American and industrial capacity. Your statement was excellent.

I thank you very much for the points that you have made.

Mr. Harbour. Thank you, sir.

Chairman Gibbons. Thank you, sir.

Mr. Frenzel. Could you tell me something about your company? You don't do business with automobile companies? Who do you do business with?

Mr. Harbour. My major customer is a drug company, and I work for a couple of defense contractors. I don't do any work right now specifically for any automobile company.

Mr. **Frenzel**. Apparently, you do some kind of work on the subject of automobiles?

Mr. **Harbour**. Following the automobile industry, Congressman, is my hobby. My blood is full of automobiles, and it is significant. I have been in the industry for 28 years and I am not going to get out of it. It is a little bit of a crusade for me, sir.

Mr. **Frenzel**. OK, you indicate in your testimony that the U.S. auto industry will take 3 to 5 years to apply the management technology required to turn the industry into a world competitive position. Isn't it going to be difficult to do that if we have locked up our borders in the meantime?

How will we be competitive to those who are selling in the real world while we are selling in a pretend world in the United States?

Mr. **Harbour**. I didn't ask you to lock up the borders, sir. All I said was this, that we can change the management technologies we have, but it will take awhile and I said 3 to 5 years, but in the interim, if you have lost a lot more of this automobile market and it erodes to 50 percent, then, fine, we become competitive at the end of 5 years for 50 percent of the market and once these facilities are closed, don't ever expect them to open.

Other than the fact that General Motors is working with Toyota, General Motor's' Southgate Assembly Plant is closed and Ford closed its Los Angeles plant.

Anybody who thinks those plants are going to reopen, is in dreamland.

We are talking about capacity. We used to have 325 major plants in this industry. We are now down to 280, approximately.

They will not reopen, and so, all I said is if we are going to keep the share of the market we have now, it will take 3 to 5 years to turn it around. I am not sure local content is the answer to that, but if they don't have time, then you better accept the fact that 5 or 10 years from now, we are going to have less than 50 percent of the market and factor that into our economic policies.

Mr. **Frenzel**. Thank you.

Your next statement in the same paragraph says that if something isn't done to stem the tide of imported Japanese cars and trucks, the auto industry will no longer be a dominant force in the economy. Hasn't something been done?

We have a qualitative restraint agreement voluntarily in force now? Is that inadequate?

Mr. **Harbour**. Yes, we have voluntary restraints up until March 31 next year. There is nothing beyond March 31. Come April 1 next year, the doors are open, the floodgates will be open and that is the beginning of the end.

Mr. **Frenzel**. Do you believe that the extension of those agreements would be helpful?

Mr. **Harbour**. I believe an extension of the agreement would help. In fact, I would like to see it a lot lower than 1.65 million units or whatever the number is.

Mr. **Frenzel**. Is that a better way of doing it than local content?

Mr. **Harbour**. Congressman, I am not a specific expert on local content, OK? Local content is going to end up affecting each company, be it domestic or international, a lot different. They are all different. There is no one generalized answer.

I am not sure if local content is the answer. I do know this, that if you open the doors in April, and allow any number of cars to come in here, we are just going to have more unemployment, and more erosion of this industry, and the rest of the industrial base that supports it.

You are talking about a country, Japan, that has the right products at the right price and the right quality to just start flooding them in this market. If you want to buy Japanese cars, be my guest, but do you want this industry or not?

It needs 3 to 5 years and if it doesn't get 3 to 5 years, don't ever look for it to be the same.

Mr. FRENZEL. Do you buy the argument raised previously that local content dooms us as a world car seller?

Mr. HARBOUR. I am sorry, I didn't hear you.

Mr. FRENZEL. That local content takes away our ability to sell in the world and produce a world car?

Mr. HARBOUR. Well, if I thought there was such a thing as a world car, I could, there is no such thing as a world car. Everybody tells me that.

Mr. FRENZEL. You are probably driving one now.

Mr. HARBOUR. No such thing. We built the Horizon and Omni at Chrysler and also built it in France. There is no such thing as a common car. That is a bunch of garbage.

All the laws of safety and emissions are different. You can't have a common car. They all have different engines, so there is no such thing as a common car.

Mr. FRENZEL. Let us speak of it in a little different way, of sourcing parts in various parts of the world and producing a cheap car in any given market.

Obviously, we are not going to be able to do that in this country under a local content, at least to any great extent.

Mr. HARBOUR. Sourcing anywhere in the world, I think some of these sourcing decisions that have been made, American Motors is an example, Chrysler bought Volkswagen engines for Horizon and Omni.

Chrysler didn't have the $200 million to tool a new engine, so they bought an existing engine. There will be some of those decisions by necessity. When you go back and talk about this industry today, you are talking about an industry that is flatout broke.

Anybody that sees an enormous amount of capital sitting around to invest in something, I don't know where they are hiding it. And GM has stopped almost completely several of its new plants, and a lot of new products. It decided to go to Japan for 600,000 small cars in the subcompact class because it doesn't have $2 billion to invest in a new car, and then again, why invest in it when you know it will cost you $2,500 more?

Mr. FRENZEL. Which car is this?

Mr. HARBOUR. Subcompact.

Mr. FRENZEL. Mr. Smith gave slightly different testimony.

Mr. HARBOUR. I am sure he would. General Motors, who bought 250,000 Isuzus and signing up for 250,000 Toyotas and 100,000 Suzukis, or 600,000 total subcompact cars to replace the Chevette, and that saved them $2 billion which they didn't have the money for anyway.

Why build it? That is a good decision on the part of the chairman of General Motors. I know it would make Wall Street happy.

Mr. FRENZEL. Thank you very much. We appreciate your testimony. You have been helpful.

Chairman GIBBONS. Our next witness is Marvin T. Runyon, president and chief executive officer, Nissan Motor Manufacturing Corp., U.S.A.

You may proceed as you wish. I noticed you there in the audience today and other days.

STATEMENT OF MARVIN T. RUNYON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NISSAN MOTOR MANUFACTURING CORP., U.S.A.

Mr. RUNYON. My name is Marvin T. Runyon, president and chief executive officer of Nissan Motor Manufacturing Co., U.S.A., a company whose principal officers are located in Smyrna, Tenn., near Nashville.

We are a subsidiary of Nissan Motor Corp., Ltd., of Japan, and we constitute our parent company's entry into the automotive manufacturing business in the United States.

The purpose of my testimony is to describe for you the likely impact that H.R. 5133 would have upon Nissan and its U.S. subsidiary, and to comment upon the effect that the legislation would have upon foreign automotive investment in the United States and the automotive industry generally.

I appreciate this opportunity to present our company's views. Moreover, both as a citizen and as president of a company that would be seriously and adversely affected by this legislation, I want to commend you, Mr. Chairman, for your determination to conduct these thorough hearings.

I have been the chief executive officer of Nissan Motor Manufacturing Corp. U.S.A. since the company was established in 1980. I joined Nissan after retiring from the Ford Motor Co., where I worked for 37 years.

I began my career as an hourly worker in the assembly plant at Dallas, and I also worked on the line at Ford's plant in Atlanta. During my career with Ford, I worked in various engineering and supervisory positions at nine different locations. I served as part of the senior management staff at Ford automotive plants in Lorain, Ohio; Norfolk, Va.; Mahwah, N.J.; Metuchen, N.J.; and St. Thomas, Ontario. During my Ford career, I had responsibility for 20 plants and about 50,000 employees as vice president, powertrain and chassis operations, and I retired from the position of vice president, body and assembly operations, in 1980. In that capacity, I was responsible for the operation of 29 plants, including all purchasing and engineering activities, and more than 120,000 employees.

My purpose in giving you my background is to let you know I have spent my career building cars and trucks in the American automotive industry. I am familiar with the impact that our industry has upon the communities where it operates, both in good times and in bad. I understand well the economic, social, and human costs of the long recession that the automotive industry is experiencing in this country. I understand the frustration that has prompted the authors of H.R. 5133 to propose this drastic, protective legislation.

Finally, I understand the sympathetic concern of those Members of Congress who have lent their names as sponsors of this legislation.

I thought it important to appear before this subcommittee today, however, to tell you that H.R. 5133 is not the answer to the U.S. automotive industry's problems. In addition, I strongly disagree with those who have tried to convince you that the bill would force new, foreign, automotive investment in the United States, thereby creating jobs for Americans. It would certainly not result in additional investment in the United States by Nissan. In fact, it would seriously jeopardize our project in Tennessee.

As you know, Nissan Motor Manufacturing Corp., U.S.A., is building a facility to produce light duty trucks. Production startup is scheduled for August 1983. These U.S. trucks will replace those which our parent company now builds in Japan and exports to the United States. Last year, trucks accounted for about 20 percent of the company's total U.S. sales.

We intend to produce 156,000 light duty trucks annually in our initial operation. The tooling will be in place to produce up to 180,000 units if demand warrants. We will also be able to add tooling within our existing facility to produce up to 240,000 vehicles.

Nissan's investment will amount to $660 million before we produce our first truck. This is the largest single investment made by a Japanese company in this country, and it is Nissan's largest investment outside of Japan. The company's total cash requirements will actually approach $1 billion before we earn the first dollar of profit from the sale of our vehicles in the United States.

Our facility will have 3.2 million square feet, or about 69 acres, under roof. The front of the building will be more than two-thirds of a mile long. It will be the most technologically advanced operation in the Nissan system—even more modern than the Zama and Oppama plants in Japan with which many of you are no doubt familiar. We will have 220 robots in our body, stamping, assembly, and paint operations.

Thousands of construction workers, earning a $100 million payroll, are building our facility. We already have 735 Nissan employees, who have been selected from some 64,000 applicants; 425 of these, including 128 hourly technicians, are receiving extensive training at Nissan plants in Japan and at our own 30,000-square-foot training center in Smyrna. Technicians and their supervisors are spending up to 5 months in Japan training on the assembly line. In total, we expect to spend more than $63 million for training prior to startup.

When we reach our planned production of 156,000 units, our work force will total 2,650. Our annual payroll will exceed $90 million. The indirect employment and economic ripple-effects of our activities will, of course, be very substantial. In fact, at least one of our U.S. suppliers, Hoover Universal, Inc., is already building a plant in the vicinity of our operation in order to supply us with finished seats for our trucks. Hoover is also supporting a construction payroll and is creating new jobs in Tennessee—clearly a result of Nissan's investment.

Why did Nissan decide to make such an enormous investment in this country? As a growth-oriented company, looking to the future in a very competitive business, Nissan's goal is to supply consumers with products of the highest quality. It has successfully pursued that objective in the United States up until this time by building vehicles in Japan and exporting them to this country. In 1972, Nissan exported 261,000 units to the United States, and that number had grown to 584,000 units by 1981.

Several years ago, Nissan's management team made a fundamental decision to shift from an export-only strategy to become a truly transnational company. Since 1980, the company has entered into a joint venture with Alfa Romeo in Italy and a tie-up arrangement with Volkswagen in Japan. In addition, Nissan has purchased a major interest in Spain's Motor Iberica, and is conducting a feasibility study related to a potential investment in the United Kingdom. Finally, it is building a major manufacturing facility in the United States.

In determining whether and how to invest in the United States, Nissan took into account future market conditions, the strengths of its product lines, anticipated demand for its products, the positioning of its competitors, and the availability of satisfactory suppliers. After intense study of these and other factors over the course of several years, the company concluded that building trucks in the United States was an acceptable business risk. Quite frankly, I doubt that this decision would have been made if domestic content legislation had been on the books at that time.

In April 1980, Nissan announced its intention to build a U.S. plant and to begin production as soon as possible.

We broke ground during February 1981 and soon thereafter began to identify available sources of supply for components. To assure our company's success in an intensely competitive market, we are selecting suppliers on the basis of their ability to meet Nissan's standards for design, quality, price, reliability of supply, and timeliness of delivery.

This process can easily require 2 years of effort, since it involves source investigation, unique tooling requirements, and sampling of parts from both prototype and production tooling for compliance to Nissan specifications and Federal motor vehicle safety standards. Testing is conducted by suppliers in conjunction with our company, which performs rigid vehicle and durability trials. Where we do not have complete testing capabilities, either components or complete vehicles must be sent to our parent company in Japan for testing. If the product fails any of our tests, we must start again.

The process of selecting suppliers has made it clear that we can expect to achieve approximately a 38-percent domestic content ratio in our first vehicles, a ratio computed by industry methods and not on the basis of the definition in H.R. 5133. Over the long term, we expect to increase this ratio. In fact, we have a mandate from our parent company to utilize maximum United States content. However, our production volume of 156,000 vehicles is too small to cost-justify the manufacture of major components such as engines and transmissions in the United States. If we tried to build major components, our costs and our prices would be significantly out of line with those of our competitors. Therefore, we must continue to import major parts in order to succeed as a manufacturing company in the United States.

Under H.R. 5133, we assume that we would be required to meet a domestic content ratio of approximately 70 percent. We have reached that conclusion by presuming that, in the absence of restrictive legislation, our company will build and sell 156,000 trucks and Nissan will sell 550,000 other vehicles in model year 1986. You will recall that the company's required domestic content ratio in 1986 is obtained under the bill's provisions by dividing its U.S. sales by 10,000. Parent and subsidiary corporations are treated as one entity for purposes of making this calculation.

For reasons that I have already outlined, it is not feasible for us to achieve a 70-percent domestic content level in the trucks that we will build in Tennessee. Moreover, even if we could reach a domestic content level of 100 percent, it would not be possible for the company as a whole to meet the bill's requirements without moving considerably more of its production to the United States. It is not reasonable to expect Nissan to increase its United States investment—which, as I mentioned before, is the largest it has made outside of Japan—long before its initial venture in this country proves successful.

Since Nissan cannot meet the domestic content ratio manded by H.R. 5133, it would be subject to the bill's import quota. That quota would apply both to the production of trucks by our company in Tennessee and to the import of vehicles produced by Nissan in Japan. It would severely limit the number of vehicles Nissan could sell in the United States and this would adversely affect Nissan's very significant marketing and sales subsidiary in the United States as well as its dealer network. These operations today provide jobs for 34,000 Americans.

What, then, would Nissan do if H.R. 5133 were to become law? I can't answer that question with certainty, but I can say without hesitation that the viability of Nissan in Tennessee would be severely jeopardized. We predict that it will be several years before our Tennessee company breaks even, and even then our projected per-unit profits will be modest. Therefore, the company could minimize the losses it would suffer as a result of the legislation by exporting lower cost vehicles from Japan up to the limit imposed by the bill, rather than by manufacturing vehicles at its $660 million facility in the United States.

Finally, Mr. Chairman, I would like to give you my best judgment of what the effects of this legislation would be on the automotive manufacturing industry in the United States. In addition to the disastrous consequences it would have on our company, this legislation would not solve the U.S. automotive industry's fundamental problems. In my opinion, it would create even more difficult ones over the long term.

First, I believe that production costs of the domestic manufacturers would increase because the bill would limit their flexibility to source least-cost components from foreign suppliers. As a result, U.S. automotive prices would increase.

Second, sales of vehicles by companies like Nissan would be restricted dramatically, because of the bill's effective quota, decreasing competition and reducing the choice of vehicles available to U.S. consumers.

Third, domestic companies would probably not benefit from the vacuum created by the limited supply of products available from large Japanese manufacturers. Instead, smaller foreign automotive companies, which export volumes requiring little or no domestic content would find their competitive positions strengthened, and their sales could expand to the limits imposed by the bill.

Mr. Chairman, I want to thank you again for your determination to conduct these thorough hearings, and for the opportunity which you have given me to present Nissan's views to your subcommittee.

Chairman **Gibbons**. Thank you, Mr. Runyon.

You have made a very forthright statement.

Since Mr. Bailey's constituent, Volkswagen of America, has said they can't live with this bill, I think I will turn you over to Mr. Bailey.

Mr. **Bailey**. Thank you, Mr. Chairman.

Mr. Runyon, we don't disagree all the time, but I do disagree with my chairman on this issue. I want to make sure the record is replete with an expression of very sincere and heartfelt respect for you.

Before I do disagree, I will characterize Volkswagen as saying they cannot live with this bill.

Volkswagen, incidentally, meets the requirements of the bill, with their domestic content, in fact, when they open the power train plant in Michigan, it would more than bring them within the confines of the bill. I know the leadership there very well, and the reasons for the policy statement that they made, and I also know what happens in terms of feelings in their intimate little hearts.

I would hope that we have a chance to examine the record, and you would examine the questions and the testimony from Volkswagen.

It is not a question of being able to live with the bill. As a matter of fact, they are in compliance right now, and they don't like it as a matter of policy. I respect your views in that regard, also, but I realize in terms of your view of world trade, that this is certainly not the kind of thing you would like to see done.

I would only say I am sure you listened to a great deal of testimony, and there are some of us that feel that some of the root causes for this type of legislation are broader than the issue, how it impacts you.

I understand that you feel it would be harmful, and I respect your views in that regard. You made a fine statement.

Mr. **Frenzel**. Thank you very much for your testimony.

We appreciate having your valuable testimony.

We appreciate your hospitality on our review of the Oppama plant. It was the conclusion of Mr. Bailey's about Volkswagen——

Mr. **Bailey**. Volkswagen specified, if the gentleman will allow me to protect the record, Volkswagen's words were, through the Volkswagen witness, Mr. Phil Hutchinson, that they are in technical compliance. They are in actual technical, complete, total, and utter compliance, period.

Their domestic content now, the Rabbits they are producing, bring them within, over all, about 15 percent within the limits.

The domestic content category, which they would be affected by would be roughly around 40 percent or so, and they exceed that requirement by better than 6 percent.

They are within compliance, and I think that the gentleman would find there is no question; the testimony from Volkswagen exhibits that. They don't like the bill because they happen to think that it represents a discouragement to investment, that kind of thing.

They want more freedom to vary domestic content, et cetera. They were very much involved in the so-called CAFE regulation work that was done on domestic content. They are in about 70-some percent of their Rabbits here in the United States, and there are some fleet averaging issues in that thing, but Volkswagen did not say that they were not in compliance. They did raise the spectre of possibly not being in compliance in the future if they did not open the Michigan plant, and you are shaking your head in agreement, so you are aware of that issue.

They said that they may not be in compliance if they did not go ahead and open the plant in Michigan.

Now, in all fairness to Volkswagen and the gentleman from Minnesota, who I also happen to revere very much, the point Volkswagen was making was if the economy did not improve significantly enough, that there was a possibility they may not open that Michigan plant, and, therefore, they were voicing a fear of the possibility in the future that they may not find themselves in a compliance situation.

I find that hard to believe on the arithmetic, and I have checked it very, very closely. It really does not work out when you look at what volume they would be doing; that it would create a problem for them, unless they increased their 100 percent nonimport mix. Be that as it may, it is their statement they may not go ahead with the Michigan plant; so that was the reason they said what they said.

Mr. **Frenzel**. I thank the gentleman for his contribution. I still prefer Volkswagen's testimony on the record to the gentleman's description of Volkswagen's testimony.

Mr. **Bailey**. I will stick with you on that. I agree. I think their testimony is on the record.

Mr. **Frenzel**. They did raise the specter of the Michigan problem. They raised the specter if they sell more or less cars, depending on the market, they raised the specter of the market rising and causing the value of the import component to rise. And they, as I interpret the testimony it was slightly different, but the truth is in the ear of the beholder, or the eye, or both maybe, so let us proceed.

You worked 37 years for Ford?

Mr. **Runyon**. Yes, sir.

Mr. **Frenzel**. A long-term contract with Nissan?

Mr. **Runyon**. No, sir. However, I do expect to work with Nissan for a long time, maybe 15 or 20 years.

Mr. **Frenzel**. Be careful, you might get to like it.

Mr. **Runyon**. I do.

Mr. **Frenzel**. I notice here, through your testimony, you restate and restate the effect on your company, which is hard to predict, but you claim it would be dire. On page 3 you say it will seriously jeopardize.

On page 5 you say that you doubt the decision would have been made if there had been domestic content legislation on the books. Then on page 6 you are a little more specific, saying you can't get the scale, even in a plant which is going to cost you $1 billion before you open the door to make the domestic content limit.

Now, what is it that causes the advocates of this bill to tell us people are going to come here to invest in America, if we pass a local content bill, when one of the best managed, best financed companies in the world can't come here and do it with a billion-dollar investment?

Mr. RUNYON. Sir, I——

Mr. FRENZEL. Who has been smoking what?

Mr. RUNYON. I certainly am not in a position to tell you what is in someone else's mind. All I can say is that we are investing $660 million before we build our first truck, and we did that on the basis of the fact that we are selling in the neighborhood of 600,000 vehicles in this country.

Nissan feels a very strong obligation, as I said in my testimony, to produce vehicles where they have large markets, and I think that they have shown very good faith in that regard by investing $660 million in a facility here to produce light-duty trucks. Trucks now account for about 20 percent of their U.S. sales. This project could only be the beginning.

But in order for it to go further, we must first prove that we will be able to be successful in this venture. This is, you know, a risk, as I said at the beginning. But Nissan felt that it was a risk worth taking because they were selling 600,000 vehicles in this country.

Where a company is selling that many vehicles, it absolutely should build production facilities. If those facilities are successful, who knows what might happen next. I think that they could not fail to expand if it is a successful venture.

Mr. FRENZEL. I agree with you. Of course Mr. Bailey agrees with you. We all do. And Mr. Gibbons and I have been a number of times begging the Japanese to invest in this country.

We are delighted that Nissan has made this first step, which we hope is only a first step, but I suggest it is absolutely shattering to think that now that you have made it, we would like to leave you with an empty shell in the hills of Tennessee. My thought would be that they would build a little altar to Nissan in every church in Tennessee rather than trying to boot you out.

Mr. RUNYON. It is rather shattering to us and it is going to be rather shattering——

Mr. FRENZEL. It is rather shattering to your 2,600 potential employees.

Mr. RUNYON. That is right.

Mr. FRENZEL. That they are relying on you for real property evaluation, to have put in the services.

Mr. RUNYON. I might add, sir, that some of the services that have been put in were put in by Nissan. We have invested roughly between $15 million and $20 million for services, such as roads, water, sewage, and so forth, in that community in order to provide infrastructure for ourselves and others in addition to other——

Mr. **Frenzel**. But the community will never be the same, and without you it is dead. They are dependent now, I guarantee you. Well, I think your testimony is of great interest, and I assume that if, when you post the question, what do you do if it becomes law? I suppose there is no answer to that, because we won't know until it comes time to make that decision. But it really frightens me.

Going on to page 9, the three results that you suggest, of course, have been suggested by other witnesses. With the exception of No. 3, at least that has not been highlighted here, do you want to expand on that a little bit, the business of a myriad of smaller companies coming in under the floors?

Mr. **Runyon**. Yes, sir, I would be glad to do that. There are several automotive manufacturers now who now import vehicles into the United States in small quantities or who do not import. For example, there is a rather large Japanese company by the name of Daihatsu that is a well-known manufacturer of vehicles in Asia and Australia but that does not sell vehicles in the United States now. It might well be possible for them to start marketing here.

Also, I have heard statements made in these hearings that volumes of anywhere from 100,000 to 250,000 vehicles with very little domestic content could come into the United States under this bill's quota restriction. So you also have to consider those companies that sell fewer than 100,000 vehicles here now. You have Isuzu, Suzuki, Volvo—I don't know, there are probably 10 companies, I can't recall all of the names right now—that would have the capability of increasing their sales in the U.S. market if the bill were passed.

That very well could equal the sales that Nissan and other large manufacturers would lose because of H.R. 5133. The point I am trying to make is that this legislation, while it is intended to create U.S. jobs, would not necessarily do that. All it would do is force some people out now, but allow other people in, and it would not create new U.S. jobs.

Mr. **Frenzel**. Thank you very much. You are the fifth or sixth auto manufacturer that has told us this thing won't work. I don't know when we will begin to listen, but I thank you for telling us.

Chairman **Gibbons**. Mr. Runyon, I think I have sometimes characterized this legislation as based upon two premises: one, greed; the other one, ignorance. Do you think any intelligent investor would bring money to the United States to invest in the automobile industry with this kind of legislation on the books?

Mr. **Runyon**. I honestly think they would have very severe reservations about moving into a country where legislation of this nature has been enacted. I think it would give some indication of instability; potential investors would not know what legislation might be enacted next. I think that it would cause people to really stop and wonder.

Now, another thing that this legislation would do is disrupt the investment planning of the domestic industry. The domestic companies would all of a sudden have to rethink where they are going to make their investments. I think it would be very disruptive for the total automotive industry, not just foreign automotive industry, but U.S. auto industry also.

I think it might also serve as an example that other countries may try to emulate. They may think that this is the way to do business, and that wouldn't be too good for our major export industries.

Chairman GIBBONS. What do you think it would do to the price of automobiles in this country?

Mr. RUNYON. It absolutely would increase the price of automobiles. When you limit the capability of a manufacturer to go outside of the United States or outside of any country to search for and purchase the best priced components which have equal or better quality, you are going to raise the price of vehicles.

I think if a study were made of those countries where domestic content laws are in existence, you would find that the prices of vehicles in those countries are considerably higher compared to what they are in the United States, and you would also find that the technology of those vehicles is not as high as it is in the United States where it is forced to be higher by competition.

Chairman GIBBONS. Thank you, sir.

Mr. BAILEY. May I ask one very quick question?

Chairman GIBBONS. Sure.

Mr. BAILEY. When Nissan wanted to locate in the United States, did you look at any empty, unused American manufacturing facilities? Were any available for renovation at all?

Mr. RUNYON. Was your question, Did Nissan look at any other manufacturing——

Mr. BAILEY. Yes, did you consider that? For example, when Volkswagen came over they purchased an already-built Chrysler plant. That has not been mentioned in the testimony, but the Volkswagen facility happens to be in my district. It is in a plant that was built by Chrysler Motor Corp. and sold to Volkswagen of America. Did you folks do that at all?

Mr. RUNYON. Yes. There was an analysis made of all of those facilities, but our decision to locate in Tennessee was made primarily on the basis of geographical location, from the standpoint of incoming materials and the shipping out of our finished products. As a single-source plant, location in Pennsylvania or California or any place that is close to an ocean is not too good because you can only ship one way from there.

Mr. BAILEY. Pennsylvania is not close to an ocean. Philadelphia is, but when you get inland you are probably not much further than Tennessee could be.

Mr. RUNYON. It is closer to the ocean than Nashville.

Mr. BAILEY. I am sure it is, but you are pretty close to the Mississippi there.

Mr. RUNYON. Yes.

Mr. BAILEY. We would be at the headwaters of the Ohio. We don't have much investment in our locks and dams, you see, down there. Twenty-five years of neglect in capital improvement by the Federal Government has resulted in that problem. We could go into a lot of those kinds of things. I want to again thank you for the testimony.

I am just wondering offhand, though, in the years you have experienced at Ford, which has made some incredible investments overseas, they didn't invest in Japan. You mentioned a lot of impediments that this legislation would raise. It is a pretty good argument as to what this legislation would raise to investment here.

Is there an analogy that can be drawn as to why people didn't invest in Japan in the past?

Mr. RUNYON. Is the question, Why people don't invest in Japan?

Mr. BAILEY. Yes. I hope you get my point. You raised objections to this legislation as a reason why people wouldn't want to invest here. One of the things you said was the confidence about what the future was going to bring, it is just not a good investment environment. We know those things are awfully important to investors. I just wondered if they were also fair in terms of describing or explaining why people hadn't invested in Japan up to now.

Mr. RUNYON. Mr. Bailey, as I stated in my testimony, I have worked in the American automotive industry——

Mr. BAILEY. That is why I am asking.

Mr. RUNYON. For 37 years, and therefore I am not really qualified to speak about Japanese rules. However, I am not of the impression that there is any restriction to foreign investment in Japan. As a matter of fact, I have heard that question several times during these hearings and I asked my staff yesterday how many people are investing in Japan. I got back a book that was about a half inch thick with about 30 to 40 entries per page. Several hundred companies have invested in Japan.

As an example, Volkswagen has a tieup arrangement with Nissan, and Nissan is going to build 60,000 vehicles in the first phase, and maybe up to 120,000 vehicles, and these Volkswagen vehicles are going to be sold in Nissan dealerships.

Mr. BAILEY. Who is Nissan here in Tennessee? Who are you tied up with here?

Mr. RUNYON. Who am I tied up with in Nissan in Tennessee?

Mr. BAILEY. Yes.

Mr. RUNYON. We are an American company that is a subsidiary of Nissan Motor Co., Ltd., Tokyo, Japan.

Mr. BAILEY. I will help you out. I have done a real good study, too. I think what we are talking about is the nature of some of those relationships when it comes to investment, and, you know what you have to go through, or what you have had to go through in the past: some of the technology, licensing agreements, arrangements, domestic requirements, that kind of thing.

I think they stand pretty much for themselves. The record is very, very clear on them, so I just wondered why, and I don't know why, but you didn't have experience in that foreign part of the business or whatever.

Mr. RUNYON. The only experience I have had with Ford was the company's purchase of a 25-percent interest in Toyo Kogyo, which was primarily to build transmissions in Japan to be shipped back to the United States to be assembled in American vehicles. Before that, however, Ford Motor Co. had invested in a company called JATCO, Japan Automatic Transmission Co., and they owned a 50-percent interest in that. Nissan owned 25 percent, and Toyo Kogyo owned 25 percent. For some reason, and I don't know the reason, Ford Motor Co. decided to sell and has sold their interest to Nissan, but——

Mr. BAILEY. That is fairly recent that that decision was made?

Mr. RUNYON. Yes, but they did have those investments.

Mr. BAILEY. The law was changed to allow that for the first time, I think, that percentage. It was changed in Japan. I just wondered about these joint ventures.

I thank you very much. Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Mr. Runyon.

Let me say I had hoped that we could go right straight on through here today, but we have been asked by the Ways and Means Committee to vacate this room for a short period of time, which of course we will have to do. I would estimate that about 2:15 we can resume. I will try to resume at that time.

Thank you all very much.

[Recess.]

AFTERNOON SESSION

Chairman GIBBONS. Good afternoon. Let us resume.

Our first witness this afternoon is from the American Honda Motor Co., Inc., Mr. Tom Elliott, assistant vice president.

Mr. Elliott, we welcome you.

STATEMENT OF TOM ELLIOTT, ASSISTANT VICE PRESIDENT, AMERICAN HONDA MOTOR CO., INC.

Mr. ELLIOTT. Good afternoon, Mr. Chairman.

My name is Tom Elliott, assistant vice president of American Honda Motor Co., Inc.

American Honda Motor Co., Inc., is a U.S. corporation chartered in California, with corporate headquarters in Gardena, Calif. American Honda is a wholly owned subsidiary of Honda Motor Co., Ltd. of Tokyo, Japan.

We appreciate the opportunity to present our views on H.R. 5133, Fair Practices in Automotive Products Act, to the Trade Subcommittee. H.R. 5133, as amended by the Ottinger substitute, imposes U.S. content requirements on companies selling over 100,000 vehicles annually in the U.S. market. We strongly oppose H.R. 5133. We have special concerns because Honda is a Japanese manufacturer which will begin U.S. car production in Marysville, Ohio, in November 1982.

In January 1980, Honda announced its intention to build a U.S. automobile factory. The plant is 900,000 square feet and is a fully integrated facility, consisting of stamping, welding, painting, plastic injection, and final assembly operations. The plant will produce our Accord model and employ 2,000 American workers.

From initial production startup, Honda will procure in the United States such items as steel, plastic resin, paint, tires, batteries, and seats. Contracts are about to be finalized with over 40 American suppliers. The local content ratio for our U.S. production at the outset will be about 50 percent. The production volume will be increased gradually and we expect to reach the plant's capacity production, two shifts, of 150,000 units per year in mid-1984, 6 months ahead of the original target. Job No. 1 rolls off the line the first week of November 1982.

The total investment in the U.S. car plant alone is over $250 million; $250 million is a very large sum for Honda. It is more than the cumulative total of all of Honda's investments outside of Japan during the past 20 years. More than 80 percent of this sum has been spent on the purchase of machines and equipment from American manufacturers. To enable high-quality production, the plant is equipped with sophisticated machinery, some of which does not even exist at our Japanese factories. Only a small number of special-purpose machines were imported from Japan.

These figures show the degree of commitment Honda is making in the United States. Honda is paying for the plant with the profits it earns in the United States. We are, thus, reinvesting in the United States the profits we make here. Mr. Douglas Fraser, president of the United Auto Workers, in his appearance before the House Foreign Affairs Committee on June 2, 1982, stated that relative to its size, Honda is making a good commitment to output and employment in the United States.

In addition to the financial and technological commitments Honda has made, Honda is committed to retaining high quality production. We believe this bill limits our flexibility to do so as it prevents us from using the best combination of resources. The bill also inhibits us from attaining optimum efficiency and competitiveness.

While we oppose the bill in principle, we have some specific problems with it because of its impact on our U.S. investment. These consequences of H.R. 5133 appear inconsistent with efforts to encourage investment in the United States by foreign automobile manufacturers. Rather, they impose an additional burden on foreign manufacturers who have built, or are building, production facilities in the United States.

Due to the existence of the voluntary restraint agreement, our sales have declined from 375,000 units in 1980 to 370,000 in 1981, to a projected level of 350,000 for 1982. This occurred just as Honda was investing $250 million in its U.S. car plant. Now, local content requirements could adversely impact Honda even further.

Since Honda will produce only the Accord model at our U.S. plant, we must continue to import other cars to complete our product line. Any foreseeable level of domestic content in the cars built in our U.S. plant over the next 3 years will not be sufficient to achieve the required fleet-wide domestic content ratio when averaged with our imported cars.

This bill poses several other problems to Honda. The lead time necessary to comply with the local content requirements is not adequately taken into account. Honda is making a good faith effort to increase its sourcing of U.S. components, but matching specifications, quality, and cost considerations with suppliers is a time-consuming process.

The local content requirements under H.R. 5133 are based on projected sales which are to a large extent unpredictable. A manufacturer can only estimate what his actual domestic content ratio will be. This inability to forecast the exact sales quantity increases the chances that a manufacturer will, despite its best efforts, fail to comply.

Just as the changing local content requirements make compliance with the bill difficult, the variable penalty is both ambiguous and unworkable. Even a manufacturer who makes a good faith effort to comply can be penalized substantially due to rapid shifts in demand. The reduction in imports is equal to the same percentage by which the vehicle manufacturer failed to meet the domestic content ratio for that model year.

This can be viewed two ways. For example, if the requirement is 30 percent and a manufacturer only achieves 20 percent, the reduction can be either 10 percent or 33⅓ percent.

A manufacturer's prescribed content level for a given year is not known until the end of that model year. If sales are running ahead of projections, one can do little to increase local content due to supplier lead time requirements; hasty, last minute add-ons will not do. Ultimately, a manufacturer could be forced to cut its sales back to a level at which local production is no longer economically feasible.

The bill also faces other difficulties in application and execution. For example: (1) What is an automotive product; for example, resins, fabric and glass; (2) how are reimported items counted? For example, U.S. aluminum, exported and reimported as completed engines by auto manufacturers; (3) how far back do you count foreign content? For example, subassemblies.

American Honda is sensitive to the adverse impact the recession has had on the U.S motor vehicle industry. We are, however, firmly convinced of the basic, underlying strength of the auto industry and have no doubt that the efforts for recovery now under way in the United States will soon bring about the re-emergence of a strong American auto industry. It would certainly be our pleasure to see our U.S. operation become a member of this strong industry.

Last, I would like to thank you, Mr. Chairman, and the members for the opportunity to present Honda's views on the subject.

Chairman GIBBONS. Your statement has been short, but succinct and right to the point. I appreciate your forthrightness.

I do not imagine you are in a position to speak for Honda of Japan, but I would imagine if you were, you would say, had Honda known of this legislation, it never would have come here with an investment.

Mr. ELLIOTT. If the legislation had been in place prior to our decision, obviously it would have been another factor which would have been considered, and it is hard to say at this point what the decision would have been.

Chairman GIBBONS. You wouldn't think it would be an incentive to other manufacturers to bring——

Mr. ELLIOTT. No; I am sure it wouldn't be encouraging to other people and we don't look upon it now as encouraging.

Mr. BAILEY. I have no questions, Mr. Chairman.

Chairman GIBBONS. Fine. Well, thank you very much.

Mr. ELLIOTT. Thank you, Mr. Chairman.

Chairman GIBBONS. We will next hear from the American Association of Port Authorities, Mr. W. Gregory Halpin, second vice chairman; and the Port of Portland, Mr. Lloyd Anderson.

We realize you gentlemen are having your annual meeting right now and you had to come away from that annual meeting to be here. We appreciate that and we hope we have not inconvenienced you too much.

You may proceed as you wish.

STATEMENT OF W. GREGORY HALPIN, SECOND VICE CHAIRMAN, THE AMERICAN ASSOCIATION OF PORT AUTHORITIES, AND PORT ADMINISTRATOR, MARYLAND PORT ADMINISTRATION, ACCOMPANIED BY PETER J. GATTI, JR., COUNSEL FOR GOVERNMENT RELATIONS

Mr. HALPIN. Thank you, Mr. Chairman.

Mr. Chairman, my name is W. Gregory Halpin. I am port administrator for the Maryland Port Administration and serve as second vice chairman to the American Association of Port Authorities. Founded in 1912 and headquartered in Washington, D.C., AAPA represents virtually all U.S. port authorities as well as public port agencies in Canada, Central America, the Caribbean, and South America. We welcome the opportunity to comment on H.R. 5133, legislation which would impose domestic content requirements on auto manufacturers selling more than 100,000 vehicles in the United States per model year.

The United States is as dependent today on international trade as it ever has been and in many ways more so. Foreign trade accounted for 24 percent of U.S. gross national product in 1981. The United States is the world's leading supplier of coal and agricultural commodities, and ranks with Germany and Japan as an exporter of manufactured products.

At the same time, the United States is vitally dependent on overseas suppliers of iron ore, petroleum, manganese, bauxite, and other strategically essential raw materials. Imported manufactures, furthermore, contribute to the lifestyle Americans enjoy and ameliorate the effect of inflation by adding to the choice of goods available for purchase at home. This all translates into significant numbers of American jobs.

In 1980, for example, the export of manufactured products, according to the Bureau of the Census, accounted for 4.8 million U.S. jobs, an increase of 46.7 percent or 1.5 million jobs since 1977, the last year a survey was made. Those 4.8 million jobs made up 5 percent of total civilian employment and 6 percent of private sector employment.

Within the manufacturing sector itself, exports accounted for 13.7 percent of all jobs and 8.3 percent of private sector employment. Furthermore, for our farmers, exports account for approximately one-quarter of all cash receipts. Between 10 and 13 percent of the coal produced in the United States is exported. Approximately one job is created for approximately every 1,000 tons of coal shipped. In brief, the United States has a big stake in foreign trade, something that is particularly significant in these recessionary times.

More than 98 percent of U.S. overseas foreign trade by volume and approximately two-thirds of it by value moves in deepdraft ocean-going vessels, which necessarily depends on the services and facilities provided by the Nation's seaports. The U.S. deepdraft port industry consists of 189 ports located on the Atlantic, Gulf, Pacific coasts, and on the Great Lakes.

In 1980, foreign cargos handled at our ports amounted to 900.9 million tons valued at $297 billion. Since World War II, U.S. ports have invested billions of dollars in new and improved cargo handling facilities, including wharves, docks, transit sheds, storage areas, container yards, cranes, and other equipment.

From 1946 through 1978, non-Federal U.S. seaport entities plowed $4.864 billion into landside infrastructure. For the 1973–78 period alone, that amounted to $1.68 billion. Today, the industry can offer 1,456 marine terminals, including 2,939 deepdraft berths. The cash value of these marine terminals is estimated to be $40.4 billion, and their replacement cost at approximately $54 billion.

Moreover, the U.S. port industry directly and indirectly provides jobs for more than 1 million persons, generates $66 billion in dollar income, with Federal, State, and local tax revenues totaling some $10 billion.

We believe that open trade policies have contributed significantly to the prosperity of the United States and the rest of the world. Furthermore, we contend that artificial barriers to commerce between nations impede national growth by reducing the challenge of competition which spurs productivity and innovation. H.R. 5133 flies in the face of all economic logic and ignore lessons bitterly experienced in the past.

H.R. 5133 has been labeled a jobs bill. While it might indeed provide some short-term relief to our hard-pressed automobile workers, in general it would defeat its overall purpose. Jobs created in the automobile industry would be more than offset by job losses in other sectors of our economy. In fact, the Congressional Budget Office concludes that the net result could be a loss of 150,000 jobs.

What that could mean for ports where imported automobiles are processed was summarized by Acting Secretary of Transportation Darrell Trent in a letter to the Honorable John D. Dingell, chairman of the House Committee on Energy and Commerce.

Secretary Trent wrote:

> Unemployment in the nation's ports would result from the loss of 1.9 to 2.9 million automobile imports. We anticipate that 7,600 to 11,600 direct jobs would be lost and 53,200 to 81,200 indirect jobs would be in jeopardy at 14 ports on the East, West and Gulf Coasts, and my home port of Baltimore.

Moreover, this legislation is almost certain to invite retaliatory action against U.S. exports by our major trading partners, provoking a trade war that would produce only losers on both sides, but with particular traumatic effects on our national economy. With unemployment approaching 10 percent, that is something the United States can ill afford.

Many years ago, with the onset of the Great Depression, the major industrial nations, including the United States, attempted to bolster their faltering economies by erecting tariff walls and other barriers to trade. That proved to be no solution at all. In fact, as most economists agree, these antitrade policies not only failed in their purpose but in many ways actually contributed to the economic collapse and resulting depression.

Shutting ourselves off from the world market at a time when the U.S. economy is weak and stumbling will only invite greater adversity. We believe that the best interests of the United States would be better served by adhering to open trade policies. Domestic content legislation, such as that proposed in H.R. 5133 and its counterpart, S. 2300, is ill-conceived and potentially self-destructive. We urge Congress to reject them.

AAPA's views are set forth in a resolution adopted by its Legislative Policy Council last June. A copy of that resolution is attached herewith.

Chairman **GIBBONS**. That will be part of the record.

Mr. **HALPIN**. Thank you, Mr. Chairman. That concludes our statement.

[The attachment follows:]

THE AMERICAN ASSOCIATION OF PORT AUTHORITIES

A RESOLUTION OPPOSING THE ENACTMENT OF H.R. 5133/S. 2300—BILLS TO IMPOSE DOMESTIC CONTENT REQUIREMENTS ON AUTO IMPORTERS AND TO RESTRICT AUTO IMPORTS

Whereas, the Association of Port Authorities, founded in 1912, represents the public port authorities of the United States; and

Whereas, these public port authorities have provided the initiative in developing a superior port system for the United States, the shoreside cargo handling facilities and infrastructure of which is valued in excess of $50 billion; and

Whereas, the Association recognizes that the United States is vitally dependent on the flow of international trade, both imports and exports, and that 98 percent of the volume of such trade moves via water carriage and is thus dependent on the port system; and

Whereas, the Association has, for many years, maintained a position supporting open international trade policies and continues to hold that barrier-free trade serves the best economic and national defense interests of the United States; and

Whereas, the Association's United States Legislative Policy Council has carefully considered H.R. 5133 and S. 2300, proposed legislation which would impose domestic content requirements on importers of automobiles, and further, would serve to restrict the imports of automobiles, the Association now concludes:

1. Open trade policies have made a significant contribution to the prosperity of the United States and the nations of the world; and
2. Artificial barriers of commerce between nations impede national growth by reducing the challenge of competition which spurs productivity and innovation; and
3. Domestic content requirements restrict the free flow of commerce, violate international trade agreements and tend to increase costs to consumers; and
4. The "Fair Practices in Automotive Producers Act" (H.R. 5133 and S. 2300) introduced in the Congress would impose domestic content requirements on auto manufacturers which sell more than 100,000 vehicles in the United States per each model year; and
5. Such legislation would have the same effect as mandated quotas, severely restricting the number of auto imports into the United States; and
6. Independent studies have shown that one direct port job and seven indirect jobs in the port region are related to every 234 autos that cross U.S. docks, and that auto imports contribute hundreds of millions of dollars to the economy of the U.S. ports and surrounding regions; and
7. Pending domestic content legislation could invite retaliation against U.S. exports and could engender adverse impacts upon U.S. ports; and
8. The effect of this proposed legislation—and the trade war it could provide—could seriously jeopardize the more than one million port-related jobs in the U.S., the more than $30 billion contribution of U.S. ports to the GPN (1977 figure) and a significant portion of the U.S. port facility investments made by the public port authorities.

Now, therefore, be it resolved that The American Association of Port Authorities opposes pending automobile domestic content legislation and will work for its defeat.

Chairman **GIBBONS**. Now, from the Port of Portland, Mr. Lloyd Anderson.

STATEMENT OF LLOYD ANDERSON, EXECUTIVE DIRECTOR, THE PORT OF PORTLAND, PORTLAND, OREG.

Mr. ANDERSON. I am Lloyd Anderson, the executive director of the Port of Portland and also serve as the president of the Institute for Transportation of the American Public Works Association, and am first vice chairman of the American Association of Port Authorities.

I am submitting my testimony here in behalf of the Port of Portland.

Chairman GIBBONS. Go right ahead, sir.

Mr. ANDERSON. The port is opposed to House measure or H.R. 5133.

The statement given by Mr. Halpin is one which we strongly endorse.

Any variation of this or this legislation itself strikes us as straight protectionism. What we believe we need is an export legislation that promotes the expansion of our export practices rather than any kind of protectionist policies with a negative impact it has.

We recognize that international trade is an important part of our community and an important part nationally of the economic impact in this country.

As Mr. Halpin has indicated, it is about one job, $1 in $4 out of our total gross national product and on the export side alone is half that.

We don't believe the legislation will generate any new jobs. In fact, as he indicated, it has the possibilities of in fact destroying some jobs.

We in Oregon are suffering substantial unemployment, some of the highest unemployment in the Nation which occurs in our State.

Legislation that passes of this sort will have an increasing impact on that employment there. Longshoremen, truckers, railroad, car dealers, distributors, financial institutions, and so on are people that are employed in the industry that we currently have flowing through our port which would be negatively impacted by such legislation.

About one job in eight in the metropolitan area of our community is impacted by international trade, and clearly this would inhibit such trade. If we are to give any kind of message to international trade, that message should be we are open for business, want more business and not try to restrict it as this legislation imposes.

I have included some detailed information on the specific impact that it would have on the jobs in our State and our community.

Our State and our community isn't the only place it has impacted. It is obviously broader than that.

It hurts the Nation, and I think particularly if we put forth an image of protectionism as opposed to one of encouraging trade, it not only inhibits the trade, but it also has the effect of causing other nations to emulate what we are doing, specifically imposing the kind of trade restrictions that we have here and it will hurt jobs rather than helping them in this Nation in the long run.

The issue is broad and complex and broader than the auto industry. It impacts all industry, and if you look at agricultural type activities in their country, and certainly in our State, any inhibitions or restrictions placed in other countries on the kind of movement we have in agricultural commodities would severely hurt us.

We have the bargaining capability now to go to the bargaining table to negotiate and get issues settled to our benefit. Negotiation with Seattle and Portland and Japan, for example, on the movement of planes in and out of this country to Japan and finally settled on an equitable basis after hard bargaining.

Our bargainers need to have a message and that is to deal in a tough fashion with those we are doing business with. Clearly, the message we have gotten out of Congress so far is that it can happen. I hope it doesn't go so far that it severely hurts our ability to trade in a fashion that leave us as we are now, as the greatest trader in the world.

Chairman **GIBBONS**. Mr. Anderson, can I interrupt you now. I have to go vote and I will be right back.

Mr. **ANDERSON**. Fine, basically that concludes my remarks in any case, but I will be glad to stay with you.

[The prepared statement follows:]

STATEMENT OF LLOYD ANDERSON, EXECUTIVE DIRECTOR, THE PORT OF PORTLAND, PORTLAND, OREG.

My name is Lloyd Anderson, Executive Director of the Port of Portland. By way of background, I also serve as First Vice-Chairman of the American Association of Port Authorities, as President of the Institute of Transportation of the American Public Works Association and have served as Chairman of the Board for the National Waterways Conference. However, I am presenting testimony today only on behalf of the Port of Portland.

Very simply, the Port is opposed to passage of H.R. 5133, the so-called Domestic Content legislation, or any variation that proposes significant trade protectionist actions. Portland's concern and opposition to this legislation stems from our recognition of the importance of international trade to our community, the Pacific Northwest, and to the country. Moreover, we believe this legislation will fail to create any net new jobs or maintain existing jobs in the U.S. auto industry—while sacrificing a portion of international trade that is a major job generator, payroll provider and economic stimulus in our community and throughout the country.

In stating my opposition, some may assume that I have little compassion for the plight of the American worker facing unemployment lines—not so. I am very concerned about jobs and employment; in fact, in my Port alone one out of eight jobs are involved in trade and transportation related activities.

Some may assume because of my opposition that I have ignored the fact that there are trade difficulties between the U.S. and Japan—I have not done so. Trade is enormously important to this country—we thrive on it—we depend on it—we benefit from it. We at the same time support efforts to improve trade relations, reduce trade barriers and increase U.S. exports. Making U.S. goods more competitive on the world markets must become a top priority.

Some have argued this legislation is needed to "send a message". A "message" aimed at one of the United States' closest trading partners and allies—Japan—and the number one trading partner of Portland and of the Columbia/Snake River system.

But what is the "message"?

Let me state the "message" in Portland. Automobile imports have a significant bearing on the economy of the Portland region, Oregon and the entire West Coast. Long Shoremen, truckers, railroads, car dealers, distributors, financial institutions, to name but a few, depend on jobs generated by this industry.

Economic impact research conducted by Economic Research Associates (of Los Angeles) in 1975 and later updated by the Port's Research Department to reflect 1980 dollars, shows that one direct job is created for every 234 cars that crosses the docks. For every direct job created, 7.74 indirect jobs are in turn generated in the community.

Last year, 266,926 auto imports crossed the Port's docks. That translates to almost 9,000 jobs that are related to these import autos. Moreover, every auto unloaded in Portland injects approximately $200 into the local economy. (For more detailed information see attachments A and B.)

As you can see, I have reason to have concerns regarding this type of legislation. It will hurt my community. It will hurt the thousands of Portland workers involved in this trade. Some might argue that what's good for Portland may not be good for the country; that Portland is only being provincial on the subject. That line of reasoning is inaccurate; this legislation is a threat to our nation's economic well-being in the future, as well as Portland's.

Presently, the U.S. exports nearly $345 billion in goods and services (1981 figures). As I understand it, that represents about 12 percent of the Gross National Product and this figure is twice as large as it was ten years ago. When you include all goods and services, the U.S. enjoyed a $4 billion surplus in trade, as compared to a deficit of $14 billion in 1979.

More specifically, with Japan we enjoy some $60 billion worth of trade, both import and export. We are the agricultural products supplier for Japan, and they buy freely—twice as much as our second largest trading partner. Some $6.5 billion worth of argicultural products were purchased and consumed by Japan in 1980.

For Portland, that translates into 4.3 million tons of import and export cargo with Japan alone—or a $3.3 billion trade relationship. Historically, more than one-third of all ocean-going commerce in Portland has been with Japan. Also historically, from Portland and Oregon, U.S. exports in dollar values have exceeded Japanese imports.

Just as you shouldn't decide this issue on the basis alone of what's good for Portland, you shouldn't decide it based alone on what's perceived to be good for the auto industry. The issue before you is not confined to the auto industry, but affects farmers, manufacturers, the service industry and ports. Moreover, we don't believe this kind of legislation addresses the critical issues facing the U.S. auto industry to become competitive again; we don't see it's positive impact on interest rates, the value of the dollar on the world market, the modernization needs of the auto industry or the need for responsiveness of the industry to the consumer markets in the U.S.

Call the legislation what it is, protectionist legislation that has the prospects of spurring on reciprocal actions and heightening emotional actions throughout the world.

We must recognize that, despite trade frictions that we have with Japan and other countries, our country has benefited from international trade. If the U.S. wants to send a "message" to Japan to ease trade barriers and access by U.S. goods to Japanese markets, I submit that the Congress has already done so by the deliberations this Committee and others have had to date. The "message" is clear. Now is the time to move on to more productive ways of solving our differences.

Go to the bargaining table—press hard for change. Use and enforce remedies already in place in the several trade and tariff forums, formal and informal. But work out our differences as you would work out your differences with any long-time friend.

I appreciate the opportunity to present the concerns of the Port on this issue and would be glad to answer questions or provide the Committee with additional detailed information on the economic impact of this legislation on Portland.

ATTACHMENT A—EMPLOYMENT IMPACT—AUTO IMPORTS AT PORT OF PORTLAND MARINE TERMINALS

Primary impact:	
Direct	1,088
Indirect	2,627
Total primary	3,715
Induced	4,718
Total impact	8,433

Source: Derived from 1979 Tonnage and Economic Research Associates Study, 1976

The direct impact is created by the flow of dollars of the providers of marine services. Direct impact results from activities directly involved with cargo movement.

The providers of these services include stevedores, bar and river pilots, tug boat operators, ship agents, customs brokers, berth agents, ship crews, ship suppliers, international banking staffs, trucking, rail and barge crews, and other providers of port services.

The indirect impact results largely from the flow of dollars by users of marine services. These include firms which export, import, distribute, store, wholesale and retail international cargo. Governmental navigation services of the Corps of Engineers, the Coast Guard and the Fire Department are also included under indirect impact.

The induced impact results from the multiplier effect. It is larger than the primary impact because of the repeated spending which occurs. Due to the ripple effect, the induced impact tends to be diffused over a larger area; while direct impact is generally more concentrated in the local area.

ATTACHMENT B—VALUE ADDED IMPACT—AUTO IMPORTS AT PORT OF PORTLAND MARINE TERMINALS

	Millions
Primary impact:	
Direct	$52.1
Indirect	34.5
Total primary	86.6
Induced	110.0
Total impact	195.6

Sources: Derived from 1979 Tonnage and Economics Research Associates Study, 1976.

Chairman GIBBONS. Fine. We will be right back.

[Recess.]

Chairman GIBBONS. We will resume now. Thank you, Mr. Anderson.

You may proceed as you wish.

Mr. ANDERSON. Mr. Chairman, I had substantially completed my testimony.

Chairman GIBBONS. All right, sir.

Mr. Halpin, I notice on page 4 of your testimony, you quote a letter from the Acting Secretary of Transportation, Mr. Trent.

Mr. HALPIN. Yes, sir.

Chairman GIBBONS. I notice in that letter that it says that jobs in the Baltimore area——

Mr. HALPIN. 6,500 and 9,900; yes, sir.

Chairman GIBBONS. That is a lot of jobs.

Mr. HALPIN. Yes, sir, it does. These are not our figures, and I would not be in the position of actually verifying those figures, but I do point out to you, Mr. Chairman, in the Port of Baltimore last year, we handled approximately 250,000 import cars. They represented an economic impact, and these are our figures in a study just completed of some $4 million, and an automobile represents more of an economic impact per unit than any other ton of cargo we handle in the port.

More is done to the car when it comes into the port, and it, itself, generates more jobs. General cargo would represent $60 a ton, and automobiles represent $174. As far as a job generator per unit of cargo, the automobile is by far the major job generator of all units coming through the port.

Again, as far as these figures are concerned, we certainly are in that area. We certainly are in these areas.

Chairman GIBBONS. That is within the ballpark; is that right?

Mr. HALPIN. Yes, sir. These are direct and indirect jobs.

Chairman GIBBONS. I do not know what the automobile manufacturing employment in Baltimore is.

I know the car that I am driving now came out of Baltimore on one Friday afternoon, manufactured there.

Can you give me some idea?

Mr. HALPIN. Baltimore has a major General Motors operation.

It is located within several miles of where most of these import cars are handled in the port. That plant has been like other domestic plants—in a very slow situation. However, it has recently been nominated by General Motors as one of the three or four plants around the country that over the next 2 years will receive major renovation and is being considered as a key plant for the future, which has made our people in Baltimore feel a lot better.

We have always been a major manufacturing center for General Motors. A number of employees in that plant—I could give you an estimate of somewhere in the neighborhood at full production between 15,000 and 20,000.

Chairman GIBBONS. All right, sir.

Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Mr. Halpin, I will try to just combine some responses to both you and Mr. Anderson together.

I understand how legislation of this type will individually impact you. I understand that, and appreciate that, and believe me, I do.

I just feel that trade has got to be both ways. I don't know if you spend any more money on, or make any more money, or the process is different for how an imported product is treated, or how an exported product is treated.

The most significant point, in my opinion, in the statements, comes at page 3, Mr. Halpin. We believe that open trade policies have contributed significantly to the prosperity of the United States and the rest of the world.

That is probably true.

It says, furthermore, we contend artificial barriers to commerce between nations impedes national growth by reducing the challenge of competition which spurs productivity and innovation.

I would like to say to you this whole thing is about a definition of what artificial barriers are. It says commerce between nations being impeded, and national growth can be impeded by reducing the challenge of competition. If something is not done, particularly in Japan, which is the obvious target of this legislation, it seems to me, then you are going to see that as an element in competition.

It is not really as you folks understand it or talk about it a lot of times. It is not just a case of a free situation of companies, free trade, all those kinds of things that exist culturally.

It is a matter of national policy, and you will see definitely in this country a national policy in reaction out of protection for a lot of the reasons concerning basic industries in particular, as we have heard before.

Now, as evidence of that, it is very significant, and I am glad you mentioned it in your statement, on page 2, you say between 10 and 13 percent of the coal produced in the United States is exported.

Mr. Halpin, what we ought to be exporting are Btu's.

You get the point of what I am saying? That is the most efficient way to export.

To be exporting our raw material like coal, and I imagine up there in Oregon you probably export a lot of raw lumber. I don't know if you do or not, but I would assume that you do.

Mr. **Anderson**. Some logs.

Mr. **Bailey**. Well, you see the point I am making is that in a free trade world and some proponents of this legislation who recognize its inherent deficiencies, feel that it is part of a general response, not a desire to hurt you people at all.

It is not a desire to protect some coveted and privileged segment of the American manufacturing scene or its labor. That is not the point.

The discussion really has gotten down to what the long-term future holds and what domestic policy errors we have made and what practices we are up against in other countries.

The one thing I really feel strongly about, that you should recognize in that context, is the concept of retaliation, because when you make that argument, it is so hard to accept, given what we have confronted in many cases for years, not that our Government has not promoted it, but that our companies have had to face what we have had to face in other countries.

I don't doubt your figures. There is some tremendous information here, and there is no doubt in my mind probably in the short term you could get hurt. I don't know in the long term if that would be true or not, but we just can't keep running around in this country talking about free trade like as if what happens in this country is what happens in other countries, fellows. That is not accurate.

Mr. **Anderson**. It is fair to say that it is acknowledged that there are a variety of levels of restrictions in different countries throughout the world. Some of those, of course, are undeveloped countries that would simply be raw material countries, and if they did not have some kind of restrictions initially while their small industries get started, compared to our fairly large and powerful country, that has far better resources to move in and compete in some of these countries, I am not at the same time suggesting by that statement that we be tender and sweet and rollover and play dead every time we get kicked around in another country.

We need tough negotiators that represent and defend American business overseas, and, as I indicated in my remarks, we need to do that within the context of having national legislation that allows our companies to compete with some of the other bigs that don't exist in this country now—to work together to compete.

When we are trading in countries like Japan and looking, for example, to shipping such things as cherries or other agricultural commodities to a place like that, what the political situation is, and their constituency.

As you are aware, there are some restrictions on moving these kinds of commodities in there.

Mr. **Bailey**. Good point.

Mr. **Anderson**. But, in acknowledging that that is true, there also has to be the acknowledgment that the political base in Japan that has held it stable since 1950 comes out of the constituency that deals in those kinds of commodities.

Mr. BAILEY. I think you have done an excellent job of touching one of my major concerns, and that is how to nudge or encourage Japan to alter her internal structures and policies, government policies, without bringing the democratic house of cards down.

She is barely better than a generation away from a type of societal organization that I think none of us want to see arise again. She is an incredibly productive and beautiful culture, a fantastic nation.

She is an absolute cornerstone and has got to be a part of what I hope will be a free world cooperation that will insure this human race transcends the nuclear weapon period to a free world order that really does foster some true free trade.

The trouble is, the problem is not represented by cherries, Mr. Anderson.

What it is represented by, and what is really, I think, the problem that I have is that, and in particular manufacturing sectors and areas, there is such a concentration of national policy and targeting.

If we continue the way we are going, it would make it impossible for some major manufacturing sectors to exist anywhere in the world if they continue to be abused.

It is not even the retaliation issue, whether or not you can sell in their market; it is selling and marketing practices in freer markets, where people think they are being taken advantage of.

Those things have got to be negotiated. National policies have got to be changed in Japan. They must learn that there is a whole world. I have talked to Europeans privately.

There is a whole world that feels they are being taken advantage of, and that is why this legislation came up. That is the reason for it. It is not a good vehicle, but more or less what is politically acceptable in this country, but not the best way to go.

Those criticisms are correct, but it is important for us when we discuss it to understand where it comes from and why.

It is a public issue now. It is going to get discussed to death. I am confident in the next year or two Japan is going to wake up and respond and try to do things a little better—I hope—but I don't know if we will be able to successfully alter the relationship between our government and our industries.

We don't want to do that here. That is not in the interests of free enterprise, and Europe does not want to do it. Government ownership won't solve that problem.

I don't know. You allude to those things in your statement.

You talk about this being a poor vehicle, and it is obvious from reading your statement that you do have an appreciation of some of the arguments that I have made here, and that is the only reason I brought it up.

I want a democracy; my little personal belief is that I want a democracy and a strong Japan. That is not going to continue if these practices continue.

The world is not going to stand for it, and it is very unfortunate that the impact of this legislation is that it comes down on your heads, and that you are victims of it right now, and I don't blame you for the arguments you are making. I did want to reveal the rationale behind a proponent like myself.

It is not a self-issue, and the chairman has done an excellent job of pointing out the fact that we have been a leader in free market and free trade ideas. How can we continue to do that if we lose the basic capacity to even support our defense industries and not for so-called fair competitive reasons? I would be the first one to say that Japanese success is not just due to Japanese selfishness; that is not true. It is due to our stupidity and our lack of responding to these things when they began right after the Second World War.

We encouraged some of these policies to do exactly what you mentioned, export capital and technology and build infrastructure, et cetera.

That is a useful goal to the world; it should not be exploited for any one nation's selfish benefit. That is really what this whole darn thing is all about.

I can't argue with you. Legislation probably right off the bat hurts you, but maybe in the long run, maybe it will cause a dialogue that will be beneficial. I liked your comments. Thanks for listening to my speech.

Chairman GIBBONS. We thank you, gentlemen, again.

We know it was with great inconvenience that you came here today.

Thank you, gentlemen.

Mr. HALPIN. I might point out that Mr. Anderson is going back to the convention. I have not been attending the convention, and while the other port directors are in New York, I have been working hard at all the business while they have been away from their offices.

I am going back next door.

Mr. BAILEY. Can we do anything with the draft in Philadelphia and Baltimore to get a few bigger coal ships in there?

Mr. HALPIN. I am hopeful that with something that is of such national urgency and logic, that we will overcome the problems we have had in the last several years.

Mr. BAILEY. You are confident in waiting for the government to respond to that need. Is that it?

Mr. HALPIN. I would rather not comment on that.

Mr. ANDERSON. The controversy right now that is occurring in New York has to do with what are the user charges and a means of financing the waterway system in a fashion that allows the small ports and ports like Delaware and Philadelphia to survive as well as the big ones like Baltimore, Los Angeles, and New York.

Mr. BAILEY. Be ever, ever cautious of those cost-benefit studies you may stumble upon. Be very careful when you look at some of those studies that don't really get down to the nitty-gritty of the fantastic job you folks do.

Chairman GIBBONS. This concludes our hearing for this afternoon. We will reconvene tomorrow morning at 9:30.

Our witnesses will be Congressman Floyd Fithian; Allen Wallis, Under Secretary for Economic Affairs; Mr. C. Fred Bergsten, Director of the Institute for International Economics, former Assistant Secretary of the Treasury, and a panel consisting of representatives from the American Soybean Association, the National Corn Growers of America, and the National Council of Farm Cooperatives.

The meeting is adjourned.

[Whereupon, at 3:10 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m. Thursday, September 30, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

THURSDAY, SEPTEMBER 30, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman **Gibbons**. Our first witness this morning is our very fine and very distinguished and very effective Member of Congress from Indiana, the Honorable Floyd Fithian.

Mr. Fithian, we welcome you here. Please proceed as you wish.

STATEMENT OF HON. FLOYD J. FITHIAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. **Fithian**. Thank you, Mr. Chairman. I would not like to delay the committee very long. I have a statement I would like to insert into the record, and I would like to make some comments on that, if that pleases the Chair.

Chairman **Gibbons**. All right, sir, your entire statement will be in the record either before or after your remarks, however you wish.

Mr. **Fithian**. Have them follow my initial remarks, sir.

This is an extraordinary bill, but, as the late Robert Kennedy once said when we had other kinds of problems in this committee, these are not ordinary times.

This committee, the Ways and Means Committee, is at the choke point for coming in this session of Congress, and I urge you to think upon that. With the extraordinary support that this bill enjoys in the House, I am sure this committee would want to facilitate the Members of this body to vote on this measure.

Japanese cars in the United States are a reality, and no matter what we do, they are going to continue to be a reality.

It is my argument, Mr. Chairman, that we ought to make them in America.

The competition, in fact, for this kind of automobile will be keen, whatever we do, and I think in the long haul, would be healthy for the big three automakers in our own country who, had they listened to many of us in 1974 and 1975 and 1976, and made their conversion efforts, would not, in my judgment, be in the problem situation that they are today.

This kind of competition of Toyota and Datsun factories in the United States would be healthy for the auto industry in the United States and certainly for the American people.

Mr. Chairman, I represent a State that is a heavy auto and auto-related parts manufacturing State.

One out of four families in Indiana derive their income from automobile and automobile-related activities.

Last week, in Indiana, in our second largest city, Fort Wayne, saw the closing, the announcement of the largest employer in that city, International Harvester.

Indiana has suffered at 11.4 percent unemployment now, and it has suffered double-digit unemployment since 1981, and over 9 percent for the last 2½ years.

Nationally, this bill means something over three-quarters of a million jobs.

As we look out across those unemployment lines stretching out from coast to coast now, all estimates are we will see double-digit unemployment figures in October, and we have a weighty responsibility here in Congress to do something now.

We have 250,000 autoworkers idle today and 500,000 additional auto-related autoworkers idled.

Some would say this is a novel approach to autos.

Australia has a content law.

We will not be the first to have a content law.

As you well know, having gone with us and discussed with us in the European parliament, there are a whole variety of activities on behalf of traders and manufacturers and farmers of all kinds coming out of the European Economic Community.

Japan, likewise. These two major trading areas have a whole variety of laws and interventions of their governments, all the way from repaying taxes on goods that are sent abroad to direct loans on behalf of their manufacturers, and their automakers.

What we are seeing in the world today is a situation where it is this kind of lineup in competition: the Japanese workers, the Japanese automakers, and the Japanese Government, on the one side, and, on the other side, in the United States, only the U.S. autoworkers and the U.S. automakers.

I sincerely believe that it is time that we, the Government, the third element, the missing part of that three-legged stool, should weigh in.

It is time that we, the Government, weigh into this equation, and, therefore, the bill that you have before you for consideration is that weighing-in. It is that time now to stand up and be counted on behalf of those hundreds of thousands of families that are unemployed out there.

No matter what we do with this bill or others, we will not see the day return when we have, as we did in the 1960's, Japanese auto portions of our market at under 10 percent. No matter if all of the fair trade legislation that is pending were passed, they would still have well over 10 percent.

I plead with you on behalf of this country and those unemployed to move this bill with expedition and speed to the floor of the House, while there is still yet time.

[The prepared statement follows:]

STATEMENT OF HON. FLOYD J. FITHIAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. Chairman, members of this subcommittee and esteemed colleagues, I appreciate this opportunity to testify before this subcommittee in support of H.R. 5133, The Proposed Fair Practices in Automotive Products Act.

I most strongly urge you to issue a favorable report to the committee and the House floor for approval, before the end of this session. Because of the dire need for this legislation, our country cannot afford to wait until we return in November for it to become law. We need domestic content requirements now, or the cost of delay will not be in dollars and cents, but in the suffering and poverty of almost a million Americans.

The members of this subcommittee are well aware of the severe depression in the auto industry and the states that are dependent on this industry. I am aware of it because my district and my state are suffering along with the automotive industry.

The automobile industry is at the low point of its existence. Sales of domestic cars in 1981 were off 32 percent when compared to 1978, the industry's last healthy year. The rate of capacity utilization in the auto industry sank to 43.6 percent in January of this year—the lowest rate ever measured for any industry. The combined worldwide operating results of the Big Four went from $4.9 billion in after-tax profits in 1978 to losses of $4.2 billion in 1980, and losses of an added $1.3 billion last year. The combined working capital of the Big Four plummetted from $13 billion in 1978 to a scant $300 million a year ago.

However, these statistics, while frightening, are not the real reason why this bill is necessary. The real reason lies in the statistics of unemployment that illustrate human suffering and poverty. A quarter of a million auto workers are on indefinite layoff, and since employment in materials and parts is double that of assembly companies, a total of three-quarters of a million auto-related jobs have been lost. That is 750,000 workers and their families who have lost their jobs and more—their bank accounts, their cars, their homes and their self-respect. While the nation nears double digit unemployment rates, we in Indiana and our sister states have been suffering those rates too long already. In Indiana, where unemployment was 11.4 percent this July, we have not had single digit unemployment since last October. It has been two and a half years since my state's unemployment rate was under nine percent. These numbers—disturbing as they are—are still cold figures that do not justly illustrate the problems unemployed auto workers face. I want to share with you excerpts from letters of some of the people who are not so fortunate as to be receiving a regular paycheck. Listen to the voices of these unemployed workers, who are asking for your help, who are asking for the opportunity to work again, who are asking for the passage of H.R. 5133.

One 33-year old unemployed auto-related worker wrote me: "I've been laid-off since January 26, 1981, with no end in sight. I've even had to resort to accepting food stamps just to survive. I'm 33 years old, if (my) company in Gary closes at the end of this year, I'll be able to start all over again. But, what about all those people in their late 40's and 50's, they'll never be able to start all over again."

Another man wrote: "I am employed at Budd Co. in Gary. I have worked there 23 years and am 45 years of age. We were told that the Budd Co. will definitely be closed before Dec. 1st of this year. I will be out of a job and all those years of seniority and hopes of early retirement are smashed! At least the passing of this bill (H.R. 5133) might protect many of my brothers and sisters working in the auto and supplier factories and even possibly create a job for me."

Another man wrote me: "I have worked for 22 years. I am now laid off. I can't find work and I don't qualify for government or state aid. Between my wife's part-time job and my unemployment, we make too much for aid but not enough to make ends meet. I am also a veteran. I served proudly in the Korean War. I helped this country, now that I'm asking this country to help me I feel that this country is throwing me out in the cold. . . . My son lives with me, he had to quit college and does not qualify for unemployment. I can't just throw him out and he can't find a job either. So here I am, just about to lose everything, listening to everyone say that the needy will not suffer."

These people are asking for a job, but they are not asking for a federally funded job. No, they are asking for a private sector job that would not bust the federal budget. While our auto workers are in unemployment lines, or even worse, no longer eligible for benefits, auto imports have increased, gaining a larger share of the U.S. car market. As if rubbing salt in auto workers' wounds, Japanese car sales have increased 37.1 percent in three years while domestic car sales have plunged 32.2 percent.

Before critics cry about free trade and international trade cooperation, let's examine this so-called free trade. The Japanese the same people who would cry free trade, prohibited auto imports until about ten years ago. Now, because of the myriad of restrictions, requirements and red tape, a U.S.-made car would cost twice as much in Japan. The Japanese also restrict imports of beef, citrus, and cigarettes. So much for free trade. Our deficits in auto trade with the Japanese reached $13 billion last year and almost $50 billion within the last five years. Other nations have realized the threat of foreign cars to their economies. Italy does not permit more than 2,200 autos a year from Japan. France has frozen the share of Japanese cars at three percent, and Germany and the United Kingdom have limited the Japanese share of the market at just above ten percent. In the United States, the Japanese already have a share of 21.8 percent. It is not too late to act, but it's getting to that point.

This bill would be much better than a tariff or quota, because it will automatically lead to more jobs snd increased investment in our country. It would eliminate the disruptions, haggling and threats that are effects of quotas and tariffs. Over thirty countries have realized this and apply local content requirements to their auto industries. Australia has a local content requirement of 85 percent. General Motors, Ford, Chrysler, Toyota, and Nissan all produce vehicles in Australia. Venezuela's local content regulations, like the one proposed here, are increased annually up to 90 percent in 1985. In Venezuela, Renault and Volkswagen assembled cars; Fiat, GM and Ford assemble cars and trucks; and AMC and Toyota assembled jeeps. Toyota, which sold 576,000 cars in the United States last year, has plants in Australia and Venezuela, but it has no plans for auto production in the United States, the largest auto market in the world. The difference between Australia, Venezuela and the United States is a domestic content requirement.

Local content requirements cannot be adhered to immediately, but VW Rabbit is a good example of what can happen. VW Rabbit began U.S. production four years ago and is now approaching the point where seventy percent of the contents of Rabbits are North American built.

One pleasant side effect of a content requirement would be increased quality of automobiles on American roads. Volkswagen of America has said that its cars built in Pennsylvania are of higher quality than German-built Volkswagens. Ninety-five percent of American-built Honda motorcycles go directly to the dealer from the assembly line. In Japan, home of Honda, the rate is only 90 percent. And in Belgium, it is only 85 percent. Thus, the very countries that export automobiles to the United States realize that if the cars were built in the U.S., they would be of higher quality.

The best side effect of this bill is jobs. The United Auto Workers estimates that enactment of H.R. 5133 would create 868,000 auto and autorelated supplier jobs in our country by 1985. Since the big Four auto makers would have to reduce the percentage of imported cars, they would employ an extra 117,000 workers and foreign manufacturers would employ an extra 146,000 workers. Realizing that every job at a vehicle manufacturer would mean 2.3 supplier jobs, a total of 868,000 jobs would be created in the private sector by this resolution. If you are one of the 868,000 this legislation would be the most important thing before Congress all year.

The effect of this piece of legislation is not confined to the automotive industry, just as the depression is not confined to that industry. The auto industry and the country's economy are inextricably linked. When the auto industry has been depressed in these last three years, the U.S. economy has been sluggish and riddled with recession. When the auto industry was vibrant in the 1950s and 1960s, so was the country. Since World War Two, every strong recovery from recession has been tied with a recovery in the auto industry. We need a recovery in the auto industry to lead the way for a recovery in the rest of the country.

Also, the close to a million people who will be put back to work by this bill will no longer collect welfare, unemployment benefits and food stamps. They will also once again be taxpayers who will contribute to the federal treasury instead of draining it.

My colleagues, for the sake of the 868,000 American citizens, whose jobs are at stake, I urge you to report this piece of legislation quickly for immediate action by the House. My district, my state and our country are waiting to recover from crippling unemployment. This bill is a giant leap in the right direction. Thank you. I am now prepared to respond to any questions you may have.

Chairman GIBBONS. Mr. Fithian, I appreciate you coming here, and I have a great deal of respect for you as a person and as a legislator. You are a very fine one.

The House's loss will certainly be the Senate's gain.

I am sorry this bill has taken so long to get to this committee. If it had not been for a mistake that the Parliamentarian made, the bill would have been here a year and a half ago.

The authors of this bill sat on it for a year and a half in the other committee, and left the Ways and Means Committee 10, or I should say, 8 legislative days to work on it, the whole committee, not just this subcommittee.

In the time that we have had it, we have offered an invitation for everyone who wants to appear.

So far, only three people have appeared in favor of it.

The United Autoworkers, the AFL-CIO and a consultant yesterday from Detroit who, not saying anything derogatory about him, had his point and said it, and then you, of course, the fourth one.

Mr. Bailey is very strongly in favor of this bill. He has left no doubt in my mind about that, and I am sure there are other people. I realize that there are about 230 cosponsors in the House, but I can't tell you how many people have come to me on the floor and said, "Sam, sit on this bill."

It is the worst piece of legislation I ever saw. They said, "Kill it for me."

I said, "I can't kill it."

Now, we could have had further hearings as well as a markup, but the Energy and Commerce Committee sat on this bill deliberately for a year and a half and tried to put this committee in an untenable position.

While I am very much in sympathy with the position you take, I have to lay the facts on the record.

It is not [illegible] fault. We have not missed 1 day of hearings. We even met on [illegible]ewish holiday, when the Congress was not in session, and [illegible]ses.

I got 4[illegible] people that want to testify on this bill, distinguished [illegible] course, have an interest in the bill one way or another, [illegible] do, but it is going to be snatched unceremoniously ri[illegible] hands before we can do anything.

It is a me[illegible] have said to others, I think that as well intended as [illegible] is, this has to be the worst piece of economic legislation I have [illegible] seen as a legislator, because if we apply it to the auto industry, where do we stop? Shoes are imported a lot more than autos, and shoes, as my friend over here, Mr. Bailey, will tell you, are very essential. No American military force has ever gone into the field without shoes.

Food is an essential, and is penetrated very highly. Garments, are very essential, too.

Our Nation needs all of these industries.

When I look at the auto and the steel industries—they are two of the sickest—I look at them, and they have the highest labor costs in the world, not only the highest in America, but the highest in the world.

The steelworkers and their companies have gone into collusion with each other, and they have put it to the American people.

Three years ago, I think, the United States Steel annual report to stockholders pointed out, in a footnote, the fact that their average labor costs for hourly employees was $28.30 an hour.

Nobody pays their labor like that. Their labor is now 80-percent higher than the average American industrial wage, and autoworkers are right behind them. The cost of steel runs up the cost of the car, and the cost of the car runs up everything else, and we have priced ourselves right out of the American market. People can't afford to buy the cars anymore.

People come up to me and say, I can't afford a new car, and I would like one.

Today, Chevrolet and Eastern Air Lines are giving away either a trip or a car—they were on television this morning—Chevrolet will give you a trip on Eastern Air Lines anywhere that Eastern flies for free, if you just buy one of their new cars.

It seems either the cost of Eastern is too high, or the cost of General Motors is too high, because we all know they can't afford to give away a product.

I am going to talk to Mr. Borman about it.

I am sorry we didn't know about the latest gimmicks with cars the other day when the chairman of General Motors was in here; but that is the situation we are in, Floyd.

Mr. FITHIAN. Mr. Chairman, let me just say that in my—in the fashioning of my remarks, I was not and would not want to leave that implication blaming this subcommittee.

Chairman GIBBONS. I realize that, but most of the people in Congress don't know the position we are all in.

Mr. FITHIAN. This subcommittee has been given precious little time to consider this important piece of legislation, and I commiserate with you, and understand your position. We may have differing views of this legislation. If you will indulge me just one moment, the Tax Code that we have seen fashioned in this country does not do much to encourage United States Steel to modernize and be competitive. How do we get more competitive if United States Steel takes its tax, its new tax-found benefits and buys Marathon Oil? I don't understand that.

We have been slow to convert. We are converting. The American automobile industry will survive, but I would ask the members of this committee to look at the comprehensive package of things that are given by our competitors, the governments, to their manufacturers and laborers.

When you remit taxes on steel coming out of Germany, and sell Japanese steel in San Francisco cheaper than the same steel made by the same company can be bought in downtown Tokyo, clearly there is an artificial trade in the world.

Were it not true and not the case, I am a great advocate of free trade, but there is no one in this Congress that could say that under the present arrangements either the Japanese or the EC competitors are competing with us on the basis of fairness, and, in that kind of an environment in the world, it seems to me, then, we must look to our own and look to the industry that we have come to depend upon over the years, and I do not want to see an America minus its auto industry and its steel industry, and that is where we are headed, and we talk about, and rightly so, the defense structure of this country and what is needed for it.

I cannot visualize running a national security program in this country minus the ability to make automobiles and steel.

So, I argue strenuously for this bill. I believe that in America we ought to be making things that are bought in America.

We ought to be participating in this, and I see this bill as a major step in the direction of that.

I could commiserate with the committee in the shortness of days that you have to consider this.

Chairman **GIBBONS**. If I thought the steel and automobile industries were going to perish, I would pass this bill to save them.

They are going to keep piling on very high management costs, and labor costs, and the steel industry is going to go out and buy more Florida real estate and buy more Marathon Oil. I think they are kind of saying, we can't control our costs any more, and we are going to get out of the business, because we can't survive. Other people will come in to take their place—there will be American concerns that are better managed.

The real problem in American industry is the management policies. We can't escape it.

It is management. They gave away the store.

Mr. **FITHIAN**. I totally agree with you, but can you dream with me for a moment as to what kind of changes in American management will take place if Japanese management—and they will come; there is no question about it; they want that 20-some percent of the American market.

The Japanese techniques, Japanese management skills will come in with Datsun and Toyota.

Can you imagine what kind of tremendous revolution this will bring about?

We could learn a lot from Japanese management. That is one of the results of this bill.

Chairman **GIBBONS**. The people who watch the economies of the world very closely and whose fortunes depend on the change of currency by a little bit are all betting against the Japanese and the Europeans.

The U.S. currency is going sky high. We are being badly penalized by that.

I don't think that the bankers whose fortunes can be won or lost overnight would be there with almost 270 yen to the dollar—well, Mr. Smith, of General Motors, says he can't make money until the yen gets down to 180 yen to the dollar.

Those who are watching the economies of the world, who overnight can lose not only their money, but could even be penalized for guessing wrong on currency exchange rates, are betting that the American economy is that much stronger than the Japanese, or the European economy, and everybody else's, and maybe that does hurt us, but it should give us some comfort to know that the currency experts say America is the strong country.

We are all in bad shape right now.

I believe they are betting on the American idea. They are not betting on the Japanese idea. They are not betting on the European idea. They are betting on the American idea.

I think that is where we are today. We feel sorry for ourselves. We have got terrible unemployment, and some awful dislocations in our system, but the people who have to bet every minute of the day, 24 hours a day, on what a currency is worth in a floating exchange rate system, say, the United States is the place.

We have heard all kinds of suggestions that the currency is being manipulated.

Nobody has ever been able to provide evidence of it.

The currencies float.

Even the Japanese have tried to push up the value of the yen. They import far more oil, just oil alone, denominated in dollars, than all of their exports of manufactured goods.

Mr. **Fithian**. I hope that those who are betting on this economy are right. I happen to be plagued with being a historian, and I must tell you that people who know more about it than I do tell me that, as we look out over the next 2 years, if we do not get off of this crazy economic policy we fashioned here under this administration, that whole segments of the American economy financial structure and otherwise are going down the drain, and that includes the entire farm credit structure, the thrift institutions, and the like.

We will be struggling with social security, and those 10 million unemployed Americans. For every 1 million of them, it is costing us $3.4 billion in social security.

If we do not change this policy, and this bill is one of the pieces to change the policy, before this administration finishes its tenure in Washington, we are going to see a major, massive and otherwise economic collapse of this country, and this committee will be wrestling with those problems mightily in the next 12 months.

People all the way from E. F. Hutton to the best of the commodity people in agriculture will tell you privately that we are headed for serious, serious trouble.

We ought to act with great aggressiveness in terms of this bill and a whole set of other changes in the economic policy we are living under if we really care about this country.

I want to thank you for letting me testify.

Chairman **Gibbons**. I want to thank you. I have a great respect for your integrity and your scholarliness, and I would like to continue this conversation with you sometime.

Mr. Bailey.

Mr. **Bailey**. Thank you very much, Mr. Chairman.

Floyd, I want to welcome you here, and I also want to support some of the things that you have said, particularly in response to the chairman's questions which were very good. It is unfortunate that much of the dialog concerning this legislation has become tangential in a sense, but, in a way, it is the best thing that could have happened.

Let me set a couple of things straight. If you are talking about wage rates in the American industry, it is not true, it is not correct, it is not accurate, and the record is replete with reference to the fact that those wage rates are comparable.

Some were higher in Europe, some said, and some others said they are a little lower, but they are comparable to European wage rates.

The testimony is very clearly unrefuted on the record, given those recommendations of currency adjustments, although it appears it is a little lower; that wage rates between the United States and Japan, again given proper currency adjustments, they are roughly comparable. That is not my quote.

I think it is a sad myth and in effect, approaches a very serious economic and policy problem in a way that interferes with the real reasons why we are here today. You talked about results, and you also made reference to causes. I want you to know, quite frankly, there have been, with the exception of two witnesses, no one that has disputed the nature of industrial policy in Japan—no one.

There have been two witnesses who said that the Japanese market or system is as open as ours, at least in terms of the automobile market.

You are laughing with good cause, because I am laughing with you.

That is so absurd, it almost seems that we should not challenge it.

I wish Mr. Frenzel was here, because he said in response, well, he does not like this legislation at all. I feel very safe in saying this, but he—in sum, said although I don't like this legislation, I think some of the criticisms are exaggerated, I think it is going a little far to say that that system is as open as ours.

It is not. Steel is not the sickest basic industry we have in this country. Most people don't realize investment in mining died a long time ago. They just have not been studying history as you referred to it. We have not made the basic industries, particularly in some strategic raw materials, that we could produce in this country, and we would get into causes for this thing, like tax structure. You are correct—we do not have a national policy that will enable us to keep those industries alive and functioning.

We have had some testimony from the American Motors president, that all things being equal, even if we went through with this bill, it doesn't solve the basic problem; and he is correct. It does not solve the basic problem.

This bill is not a perfect remedy, and I agree with you when you say you wish you were not here having to support it, because you would rather be talking about different things.

The trouble is, when you go out there and talk to automobile workers or American businessmen anywhere, quite frankly, when you talk about the root causes and the root problems, you are hard put to say you shouldn't be asking for this.

They can look you in the eye and say, this has been a long time coming and we are being used. We are being used.

I don't know how much evidence has to be on the record for the causes of this thing. I don't know why this legislation is such an imperfect piece of legislation. I don't know, but an honest, unemotional, rational evaluation of why this policy is being offered compels us to look at the root causes, not taking people with names and accuse them of things that they don't deserve.

That part of the dialog has to stop, or it will create more division in America, more anger among the people that want this legislation, and it will do more to disserve the changes in policy that are necessary in other countries, and it is a shame that we get into that.

You are 1,000 percent correct. This bill is too little, too late, and although it is the only game in town and the only way available to us, it is the only thing that will make some people listen and start to respond to the failures of the United States of Amerca and its Government to be realistic about free trade.

We no longer run the world, economically. And if we are going to maintain a strong position in it or be its leader, which we should be and hopefully will be, and maintain that defense strength that the chairman is very correct in alluding to, then we have got to maintain some basic industrial strength.

Now, if we can't do that, all things being equal, the chairman is right. Then maybe he can blame management. I don't share that view. He has some proper criticisms, I believe.

At least management says that he does. I have not heard witnesses come in here and every time I complain about wage rates, every time I asked that question, I have not had a witness contradict my questions, not one.

The fellow that came closest was the representative from the National Association of Manufacturers, who referred to wage settlements.

I think you are an outstanding Member of Congress. I have watched you work, and feel it was a loss to this country when you were reapportioned out of existence, and I wish you luck in the Senate, because the country needs you.

I have not always agreed with you, but darn it, you know what you are talking about, and you do your homework. If you look at the investment environment for basic industries in the United States of America, if you look at the extent to which plant and equipment in the steel industry needs reinvestment and the extent to which it is leveraged, and then you look at the equity existent in that oil in the ground when the purchase of Marathon was made, when you consider the undulations in American business cycles and when you consider the fact that United States Steel did not divert a single cent of planned reinvestment in the steel area which they had announced prior to the Marathon sale, you will find that criticism of that move has largely died down, because diversification with a company in that situation makes sense.

If that is stupid American management, I don't know, but I will say this much about American management: Why is it that all of the automobile companies and all of their labor, and all of the steel management and all of the steel labor and all of the mining management and all of the mining labor, and we can look at aeronautics and utilities and pulp and paper and railroads, why do they all share these generic problems in the United States?

Why do we find a different relationship between them and their governments in other countries?

You have been down here longer than I. Have you been part of writing a policy for targeting an industry? Another country? If you have not, you better get on the stick, because you are late. I am trying to avoid national confrontations.

The issue isn't bad Americans who are selfish and greedy. Quite the contrary.

You give them the environment to operate—they did the things we wanted them to. They went overseas to invest, steel and autos.

Our administration encouraged that policy. That was part of our policy. It is not proper at this time to blame them because our capital shortages or money costs a lot or nobody wants to go out and lend you $4 billion to invest in continuous casters but they will lend you $2 and $3 and $4 billion to buy oil wells.

That is the truth. That is what needs to be on the public record. If we can blame those people, fine, we will change them. That will not change the basic ground rules under which primary industries in the United States of America are suffering.

I compliment you for being here, and I thank you so much for listening to me preach from up here, but you know, these issues have been raised with every witness that has come before the committee, and it is a consistent pattern of their response.

We have not heard a single attack on the wage issue, because those prices are the same over there.

One of the automobile companies talked about absentee problems and I said nothing at the time. I worked plant protection in an automobile plant one time. I can remember a 2-week period where we took 12 employees out of that plant that went bats on that job.

Now, somebody that stood at a plastic intrusion press like I have for 8 hours hitting 2 buttons so your hand is not in that machine, letting that thing come out, and if you go too darned slow, and don't hit that button quick enough, you got a white hat telling you you better get that thing moving quicker.

Those jobs are not easy, and some of them require a great deal of skill. It is wrong to put those people down when in fact their counterparts in other countries have also earned the right to high industrial wages and safety on the job.

Now, it is wrong to do that if that is not the cause why this situation has arisen in America. It has arisen in America because of a lack of industrial policy to address this Nation's basic economic and military needs. We need help from allies and we have fought them in the past, and we have succeeded in winning and we need to sit down and negotiate.

They have not cooperated with us. What has it taken to get the Europeans to admit that an artificial oversupply of steel and dumping in the American market has caused a lack of investor confidence in the United States of America?

It has caused a lack of investments in plant and equipment. That is the truth. I heard people say, "I don't want to invest in steel, because I don't like to make steel." That is stupid. Why do they do that?

They sit down there and say, "Here is where the money is going, here is where the future is, and I have got to maintain my position in the business community in America." This is the way things are done, and there is no government policy to encourage depreciation in a different way or accelerate it or encourage investment, and the last President we had that recognized this need was a fellow named John F. Kennedy, who came up with the idea of an investment tax credit, because he saw the trend of things to come.

He turned around and browbeat the industry on the basis of price increases for steel that killed them even worse. Thanks for letting me get this off my chest.

I believe this bill has offered a forum for getting the truth out about the causes for this problem. It is not bad Americans and not bad Japanese, but it is two different systems, and they have to accommodate one to the other.

Either we have to change to stay competitive or they will have to change, because they believe in an open, free international system. Japan is really the issue, and I hope we will all realize that sooner rather than later, and quit simplifying this thing and hanging the tail of the donkey on the side of the beast as opposed to its proper place, right above you-know-where.

Mr. **Fithian**. My compliments, Mr. Bailey, I certainly appreciate your sincerity and your conviction and I want to thank you for your comments about me personally.

I was the first to introduce local content legislation in either the House or the Senate. My initial thought, that is the way to get the attention of the Japanese in many of the unfair practices that were involved.

We don't even have a remotely fair trade situation so my thought, almost 2 years ago now, was to introduce a content bill and see if we can get some cosponsorship, capture the attention of the Japanese and start talking about the unfair trade, the inequity that is in the system, but from that point to this point I have come a long way in my thinking, because I do not now believe, given the structure of the economic world, that that kind of fair trade, largest, is going to be forthcoming from the Japanese.

Long since, you know, I have moved to the support of this bill on the merit of the concept itself and no longer am simply working on this to get the attention of the Japanese in the hopes that they will, out of their magnanimity, become more fair trade partners.

I thank you for your indulgence.

Chairman **Gibbons**. Certainly you know there is a difference of opinion on this committee.

Mr. **Fithian**. I thought that I had detected that.

Thank you again, Mr. Chairman.

Chairman **Gibbons**. Yes, sir.

Our next witness is from the Department of State, Allen Wallis, Under Secretary for Economic Affairs.

STATEMENT OF ALLEN WALLIS, UNDER SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF STATE

Mr. **Wallis**. I appreciate the opportunity to testify on the proposal to require a certain percentage of local content for goods sold in the United States.

The legislation you are considering, H.R. 5133, would require, among other things, an increasing percentage of domestic content for automobiles sold in the United States, reaching 90 percent for the larger manufacturers by 1986.

The administration strongly opposes this bill and the whole idea underlying it.

As I am only a few weeks removed from a university, and only a few days after being sworn in my position here, I am tempted to review the powerful economic arguments against protectionism. I will give in briefly to that temptation, but will, as befits my position in the State Department, concentrate on our international obligations and the international implications of this legislation.

The prosperity of the United States has resulted in large measure from free trade. We are the largest free-trade area in the world. Since the Second World War, we have gained enormously by a steady reduction throughout the world in barriers to trade.

Anything imported from abroad creates an equal demand for exports from us, because foreigners will not send us the products of their labor, machinery, natural resources, and brainpower if all they get in return is little pieces of paper with green backs.

Those who sell to us may buy not from us, but from third parties, and the third parties from fourth parties, but eventually somebody is going to show up in our markets demanding goods and services equal in value to those we got when we paid out the dollars.

This system makes everyone better off because it makes possible a degree of division of labor and specialization that is not possible in small areas. Division of labor produces prosperity, and division of labor is limited by the extent of the market.

International free trade, by greatly expanding the extent of the market, enlarges the opportunities for division of labor and thereby increases standards of living.

My colleagues in the executive branch, your staff in the Congressional Budget Office, and representatives from the private sector have elaborated at length on this analysis, so let me turn to international issues.

The most important point is this: We all know the advantages of an open and fair trading system based on comparative advantage. In addition to providing economic benefits, trade serves as one of the vital links helping to hold the world community together.

I fear that the unraveling of present trade relationships and commitments, which I will discuss in a moment, would have harmful consequences extending far beyond the trade sphere alone. We must avoid this result.

Local content laws are a derogation from our obligations under the General Agreement on Tariffs and Trade [GATT]. Local content laws also run counter to our longstanding policy of encouraging open and fair trading among nations, which, though too often honored in the breach, has nevertheless fueled the economic progress achieved in this country and throughout the world since the end of the Second World War.

The history of our trade relationships over the last 37 years is one of widening access to markets here and abroad.

Through the establishment of the GATT in 1947, several rounds of multilateral trade negotations, and various bilateral agreements, the United States has brought about a major reduction of tariff barriers.

The thrust of this position has been and continues to be critical for a nation that trades as much as we do. It has also contributed largely to the economic strength of our allies in Europe and of Japan.

Passage of the local content legislation now before you would reverse this trend, it could revive the specter of protectionism and "beggar-thy-neighbor" policies begun with the Smoot-Hawley tariff, and the disastrous retaliatory trade war which followed it.

That example, and the ensuing economic catastrophe of the thirties, give us ample grist for sober reflection on this legislation.

Under the rules of GATT, a derogation from our commitments would normally lead to a request for compensation from our trading partners whose interests were damaged by this action.

Compensation usually takes the form of lowering U.S. import barriers on other products equivalent in value and importance. Alternatively, the country damaged by the action could withdraw concessions affecting an equivalent trade value for American exports in the foreign market.

As the committee knows, the administration's authority to negotiate reductions of our tariff barriers has expired. We would be unable to offer compensatory reductions of trade barriers. We would, therefore, be forced to attempt to negotiate withdrawal of concessions by our trading partners.

Moreover, and I stress this point, in such a negotiation, or even worse, as the target of unilateral retaliatory action, we would not be in a position to choose the sectors which foreign governments might select for increased barriers on our exports.

In this connection, it is important to stress the export dependence of some of our major industrial sectors. It is often said that one U.S. job out of seven, and 1 acre of U.S. farmland out of 3, depend on exports.

Withdrawal of foreign concessions could, for example, seriously affect U.S. exports of commercial aircraft, high-technology electronic products, machine tools, or agricultural products such as soy beans, citrus, and beef.

Coal and wheat are two other important exports which could be affected.

Even without withdrawal of concessions or foreign retaliation, it is likely that the decline in U.S. imports resulting from this legislation will have an economic ripple effect on our trading partners which will lower their demand for U.S. exports.

Can we explore a moment the demonstration effect of H.R. 5133? The example of the United States, a major force in international trade, setting local content barriers to imports could lead other nations, even nations not directly affected by our own restraints, to succumb to protectionist pressures.

This is a particular risk when, as now, so many countries are undergoing recessions. The thought of unraveling of the GATT and other commitments to open trade threatens significant damage to the world trading system, the volume of international trade, and the economic health of the industrial world.

We and our trading partners are now preparing for a ministerial-level meeting of the GATT contracting parties this November. This meeting will come at a critical time for the world economy and the world trading system.

At the Versailles Summit, the participants undertook to resist protectionist pressures. To succeed in this endeavor we must make progress. To stand still is to move backward. The GATT ministerial, we believe, needs to address important new trade problems of the 1980's, such as services, high technology, and agriculture, areas where we have the most to lose from restrictive practices.

Passage of this local content legislation would undercut the ability of our negotiators to achieve our objectives for the GATT ministerial and the world trading system. Further, it would be seen by others as justification for taking a do-nothing approach, or worse.

There are unquestionably inequities in the international market. There is, I know, a great deal of frustration among the American public, in the American manufacturing sector, and in the Congress because some of the advantages that we offer to foreign countries are not fully reciprocated.

Indeed, some of our trading partners seem to be taking advantage of our commitment to sound economic principle. Resort to protectionism is not the way to solve this problem. It is rather by example, persuasion, and the use of and strenghtening of existing remedies under domestic and international law.

This is the course we are attempting to follow in multilateral and bilateral conversations with other nations. However, it is shortsighted and futile to attempt to remedy a complex problem with an awkward solution that would further damage a world economy already suffering from the stresses of high oil prices, inflation, underutilized capacity, and unemployment.

I join my colleagues in the administration and those who believe in an open world economic system in urging most strongly that this bill not be passed.

Chairman GIBBONS. Thank you, Mr. Secretary.

Mr. Secretary, I have just received word that you must leave shortly so I will not ask you any questions at this time.

I will turn you over to Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Congratulations.

Mr. WALLIS. Thank you.

Mr. BAILEY. I have read your statement, and until I got to the last page, I was rapidly losing confidence, but I did regain it.

I think the perceptions of this bill and its value are basically very well said by you, but I think maybe we view the reasons for it differently, I don't know, but the rationale, the anger and frustration, perhaps, is a little greater in my case than in the case of some Americans.

I will read from your statement at the top of page 6.

> There are unquestionably inequities in the international market.
>
> There is, I know, a great deal of frustration among the American public and the American manufacturing sector and in the Congress, because some of the advantages that we offer to foreign countries are not fully reciprocated. Indeed, some of our trading partners seem to be taking advantage of our commitment to sound economic principle.

That is just an excellent description, although I must say to you, and I mean this most respectfully, it is a gross understatement. I hope the record will show that you smiled in response to a point that I am obviously making, in the eyes of many Americans, and I happen to be one of them.

I don't think this bill will eventually become law, but I hope that it does, and it is not because it is the most perfect way to go.

You heard the remarks of the witness just before you and that is just the culmination of a lot of frustration that has been built up over the last couple of weeks. You understate the problem. I wish you luck, and I hope we can devise some policies to discourage the things that made this bill a political impossibility.

We would not have gotten to it if we had done some things differently years ago, and we would not have gotten here if some of our trading partners had been more responsible, fair, and reasonable.

They performed a classic job of doing what one witness referred to the other day of slow walking us to death.

I hope you will prove more adroit at dealing with what has been a very successful technique so far, and I invite any comments that you may have, but I thank you for a fine statement.

Mr. **Wallis**. Well, thank you very much.

I really don't have any response to that.

You have agreed in general with what I said, and I should say, before I came down here, I was on the boards of a number of corporations, all but two of which had serious Japanese competition, Mr. Bailey.

Mr. **Bailey**. I hope in your new capacity, you will study that system over there; you will get to the reasons why, because the reasons are not lazy, incompetent Americans at all.

Mr. **Wallis**. I agree entirely with you on that subject.

Mr. **Bailey**. I thank you; God bless you.

Chairman **Gibbons**. Mr. Conable has just joined us.

Mr. **Conable**. I know him better than you do. I would like to welcome you before the committee.

I suspect this begins a long and fruitful association, confrontation, cooperation, partnership, any number of different things that you will be doing here with the committee as time goes on, Allen, and I just want you to know we are all very grateful for your willingness to accept the public responsibilities you have taken on.

They are very considerable, and the intensity of feeling about the domestic content bill is a pretty good indication of what a battleground we will have in terms of economics over the next few years.

I hope that the State Department, with the top economists they now have heading it, the top three, I think the State Department is going to have to have a lot of input and accept a lot of responsibility, if we are to have a long-term course that will be constructive and give us some confidence that our future can be as bright as our past.

The domestic content bill is a troublesome piece of legislation. We are all aware of the great difficulties in the auto industry and, of course, that puts an emotional surcharge on trying to do something, but I don't think many of us want to do something, even if it is wrong in this area, and we do have to take a longer term perspective and try to find some basis for continuing and improving American competitiveness rather than sheltering it in ways that would reduce it.

I am sorry I did not hear your testimony here, but I am persuaded that this is symbolic only of a deep-seated concern generally that is felt in this body, the Congress, about the future of American industry.

Generally speaking, can we say that American goods are competitive?

Is that part of your testimony? I acknowledge that cars may be temporarily at least uncompetitive in some aspects, but, generally speaking, aren't American goods competitive in the world?

Mr. WALLIS. I certainly think that, generally speaking, they are. Of course, some are and some are not.

We are both familiar with the photographic industry, and you probably are aware of the fact that Kodak has sold several hundred thousand cameras in Japan in the last few months.

Mr. CONABLE. I was not aware of that.

Mr. WALLIS. Their largest single customer is a Japanese distributor; it is a Tokyo firm, Mr. Conable.

Mr. CONABLE. I consent to Mr. Bailey's yippee being in the record.

Chairman GIBBONS. The Japanese can use the camera. They don't have to drive it down the wrong side of the road. You don't have to rebuild a camera when you get it to Japan.

Mr. WALLIS. As far as I know, you have to buy Kodak film to use it.

Mr. CONABLE. I expect they will quickly accommodate to that. Fuji is an excellent film-making company, and they make a good film, and obviously Kodak is not a worldwide monopoly.

Fuji is selling in this country, but the point is, American goods can be competitive and should make the effort to the extent we can. We may have some short-term problems, but I wonder if the content bill were to go into law, if that might not quite possibly create more long-term problems than it would solve?

Mr. WALLIS. I think it would unquestionably damage Rochester industries, specifically where over a third of the industrial output is exported.

It would knock that into a cocked hat.

Mr. CONABLE. I don't have the reputation of being terribly provincial.

I do represent the Rochester area and think in those terms.

With the foreign market expanding faster, to cut ourselves out of it by short-term measures would be a serious mistake.

Mr. WALLIS. Probably the biggest single interest is our agricultural trade.

Mr. CONABLE. In that area I believe Japan is the largest single customer of American agricultural produce in the world, is it not?

Mr. WALLIS. I was not aware of that, but I do know that they have a lot of barriers that I have heard about.

Mr. CONABLE. I must say Japan is a very heavy customer of American agriculture. Perhaps we sell more to the European Community, as such, if you consider that one economy; but aside from that, I would be surprised if Japan was not our largest customer.

I don't use that as an argument against the domestic content bill. I am just concerned about a proliferation of what, in effect, would be a quota mechanism which would be anticompetitive to a much greater degree than tariff adjustments might be.

I acknowledge that tariff adjustments should be negotiated and not legislated, but clearly we should not negotiate quota arrangements either if we are going to break down into a whole series of bilateral arrangements similar to those which are proliferating in Europe right now with respect to informal quota arrangements.

I am sorry, I have been wandering here. I appreciate again your willingness to taking on the responsibility you have taken on and look forward to a long association here.

Mr. **Wallis**. I hope it will be as pleasant as the last 20 years, and as educational for me.

Mr. **Conable**. Thank you.

Chairman **Gibbons**. Thank you very much for coming, Mr. Wallis.

With the kind permission of Mr. Bergsten, we are going to have to call the National Corn Growers of America, Mr. Parsons, right now, because of his other commitments today.

STATEMENT OF JACK PARSONS, PRESIDENT, NATIONAL CORN GROWERS ASSOCIATION, ACCOMPANIED BY FRED V. HEJDUK, WASHINGTON REPRESENTATIVE

Mr. **Parsons**. I am Jack Parsons, a corn and soybean farmer from Wapello, Iowa.

Mr. Chairman and subcommittee members, I am appearing before you today in my capacity as president of the National Corn Growers Association. Accompanying me today at these hearings is Fred Hejduk, the director of government affairs for the National Corn Growers Association.

The National Corn Growers Association [NCGA] is made up of corn producers from 17 States, with the purpose of promoting the general welfare of U.S. corn farmers by maintaining and developing domestic corn production and price and income support programs consistent with a market-oriented grain economy.

With members in 48 States, the National Corn Growers Association includes State-affiliated organizations in Colorado, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Michigan, Minnesota, Missouri, Nebraska, New York, North Carolina, Ohio, Pennsylvania, Virginia, and Wisconsin. These States account for over 90 percent of total U.S. corn production.

We appreciate the opportunity of testifying today in order to express serious reservations and opposition to possible enactment of this legislation. H.R. 5133, if passed, would pose serious problems for the U.S. corn industry through the potential implementation of retaliatory measures that would jeopardize current and future export markets for corn and corn byproducts.

As you well know, the U.S. agricultural industry is a bright element in an otherwise dismal balance of payments that exists between the United States and her trading partners. This remarkable record of agricultural exports not only benefits U.S. farmers, but also returns needed revenue to a now struggling U.S. economy.

The U.S. corn industry plays a vital role in the overall effort to improve the U.S. balance of payments through increased grain exports. Although we have achieved a successful record of corn and corn byproduct exports, even larger volumes will be necessary to sustain a viable U.S. corn economy. U.S. corn farmers produce and harvest a commodity valued at $22 billion annually. In addition to the significance and importance of this crop to the domestic economy, U.S. exports of corn have averaged over 50 million tons during the past 5 years. These exports, valued annually at $8 billion, create numerous jobs for the U.S. labor force and return valuable hard currency to the U.S. economy.

U.S. corn farmers readily acknowledge that artifical trade barriers employed by other countries are a definite deterrent to expanded agricultural exports. The imposition of feed-mixing requirements, the grain resell regime, and import quotas on meats in Japan, as well as variable import levies, commodity export subsidies, and potential import quotas on corn byproducts in the European Economic Community [EEC] have all served to undermine the position of U.S. agriculture in world markets. Moreover, we believe these are crucial obstacles that must be overcome if we are once again to enjoy a profitable era in corn farming.

In order to achieve these objectives, we have, and will continue, to explore both official and unofficial avenues to negotiate solutions to existing trade disputes. It is important, therefore, that the position of the U.S. agricultural industry not be weakened at such a critical time in our efforts to secure equitable solutions to these problems.

The protectionist sentiment that is building in the United States must not be allowed to overshadow the serious ramifications that may result from legislation of this nature. The passage of H.R. 5133 would simply "open the door" for retaliation on the part of countries affected by the mandate of this bill—countries, I might add, that are valuable export markets for U.S. agricultural commodities.

It is not realistic to suggest this legislation is single-issue oriented and, therefore, can be confined to its potential impact on the U.S. automobile industry. H.R. 5133 will have reverberating effects throughout the entire U.S. economy. Historically, protectionist and other trade restrictive measures have produced similar results.

The National Corn Growers Association quickly recognized this when the partial grains embargo was imposed against the Soviet Union in January 1980 by President Carter. In order to support our position, the association commissioned a study on the economic impact of the grains embargo.

For your information, we are providing you a copy of the "Effects of the 1980 and 1981 Limitations on Grain Exports to the U.S.S.R. on Business Activity, Jobs, Government Costs, and Farmers," prepared by Schnittker Associates for the National Corn Growers Association to be included in the record.

The findings were overwhelming—the embargo cost the entire U.S. economy reduced value of inland transportation at $175 million, reduced value of ocean shipping at $365 million, balance-of-payments losses of up to $4.4 billion, $11.4 billion in overall national output, 310,000 jobs, and $3.1 billion in lost personal incomes earned in the United States.

I would propose, Mr. Chairman, that the possibility of similar adverse effects would not be a reasonable price to pay for the enactment of domestic content legislation.

The required ingredient in developing and demonstrating the reputation of being a reliable partner in the international marketplace cannot be achieved by such "reliability" on a sectorial basis in international trade. Past embargoes and current restrictions on U.S. agricultural exports, along with restrictions on U.S. exports of equipment and technology to Western European firms engaged in trade with the Soviet Union on the gas line project, only reinforce the foreign perception that the United States has, is, and will continue to attempt to use trade in any sector to influence political behavior and performance of governments.

We are firmly convinced the implementation of domestic content legislation will only serve to prolong this dilemma, and exacerbate an already serious situation.

Our organization must point out that Thomas W. Gleason, the president of the International Longshoremen's Association [ILA] called H.R. 5133: "A fragmentary approach that will complicate our own responses, hamstring our negotiations and create far more dust than it can settle."

In addition, the U.S. Trade Representative, William Brock, in assessing the provisions of H.R. 5133, stated: "We must not enact laws which will force U.S. trade policy to require bilateral, sectorial, or product-by-product reciprocity."

The National Corn Growers urge you and your colleagues to reject H.R. 5133 because of its complete import protectionist purpose. It is short-sighted legislation, which could only create greater trade tensions between the United States vis-a-vis Europe and Japan.

Moreover, the passage of H.R. 5133 would violate the indivisibility of trade among countries in nonstrategic goods and commodities. International trade—agricultural and industrial—must move on a two-way street. H.R. 5133 would simply stop such trade flows.

Mr. Chairman, we will be pleased to attempt to answer any questions you and your committee members may have about our statement.

[An attachment to the prepared statement follows:]

EFFECTS OF THE 1980 AND 1981 LIMITATIONS ON GRAIN EXPORTS TO THE U.S.S.R. ON BUSINESS ACTIVITY, JOBS, GOVERNMENT COSTS, AND FARMERS

(Prepared for National Corn Development Foundation for distribution by National Corn Growers Association by Schnittker Associates)

SUMMARY

1. The President's action of January 4, 1980, suspending or stopping shipments of agricultural products to the Soviet Union, directly affected 13 million metric tons (mmt) of corn, 4 mmt of wheat and 1.3 mmt of soybeans and meal that was destined for the U.S.S.R. in 1979-80 shipping season. U.S. exports of those products in the 1980-81 season (July 1, 1980 to June 30, 1981) and subsequent years were also substantially reduced. While these effects at first were partly offset by increased exports to other countries, losses to industry, the government, and farmers were substantial.

2. The principal effects of the action outside the farm sector itself were on inland transportation, ocean shipping, labor use, the U.S. balance of payments, federal expenditures, and personal income.

3. Estimates of direct losses and costs in the affected sectors include these sectoral impacts:

Reduced value of inland transportation—$120 to $175 million.

Reduced value of ocean shipping—$240 to $365 million.

Balance of payments losses of up to $2.5 billion arising directly from lost exports, and up to $1.9 billion arising from lower unit values of all U.S. grain exports in 1980 and most of 1981.

Direct U.S. government costs of $1.5 billion for acquisition of additional commodities, and $1.0 billion for interest, storage, and handling arising from owning the commodities for a period of years.

Additional target price payments to wheat farmers of $375 million.

The most important impacts, however, were those that take into acount not simply the above sectors that were directly affected, but producer and consumer sectors on a national basis. There we estimate losses of $11.4 billion in overall national output, 310,000 jobs, and $3.1 billion in personal incomes earned in the United States.

IMPACT OF LOST EXPORTS TO THE U.S.S.R. IN 1980 ON THE U.S. ECONOMY

[Dollars in millions]

	Nationwide losses in—		
	Output	Employment—no. of workers	Personal income
Corn	$6,863	189,630	$1,806
Wheat	3,014	79,508	856
Soybeans	1,568	40,635	445
Total	11,445	309.773	3,107

4. Indirect, intangible, and future effects of both the 1980 action and its unofficial resumption in 1982 have far reaching implications for the United States.

The United States has become the residual instead of the principal supplier of agricultural products to the Soviet Union.

The United States may export only very small tonnages or perhaps no grain at all to the U.S.S.R. in some future years under certain economic and political conditions.

It will be very difficult to negotiate a favorable United States-U.S.S.R. grain agreement in view of export availabilities from the other countries.

Encouraged both by a expanding world grain market in the 1970's and by U.S. "stop and go" export policies, other exporting countries have increased both their transport and loading capabilities and their grain production.

5. A general trade embargo banning the export to United States goods to the Soviet Union in 1982 would almost inevitably cut off or seriously reduce this trade for many years. Such an action would be inherently an action whose direct impacts would fall principally on the farm sector and allied industries, since most of our exports to the U.S.S.R. are of farm origin.

If such an action prevented the shipment of 24 mmt or 945 mil. bu. of corn over 3 years, plus 12 mmt or 441 mil. bu. of wheat and 3 mmt or 110 mil. bu. of soybeans, before it could be ended in (say) 1985, the overall economic costs would be as shown in the table below.

IMPACT OF LOST EXPORTS TO THE U.S.S.R. IN 1982-85 ON THE U.S. ECONOMY

[Dollars in millions]

	Nationwide losses in—		
	Output	Employment—man years	Personal income
Corn	$16,586	458,346	$4,365
Wheat	11,474	302,731	3,260
Soybeans	4,814	124,740	1,368
Total	32,876	885,817	8,993

EFFECTS OF THE 1980 AND 1981 LIMITATIONS ON GRAIN EXPORTS TO THE U.S.S.R. ON BUSINESS ACTIVITY, JOBS, GOVERNMENT COSTS, AND FARMERS

This report provides: (1) a brief description of the suspension of sales and shipments of agricultural products to the Soviet Union by President Carter from January 1980 to April 1981; (2) a description of the economic sectors directly and indirectly affected by that action; (3) estimates of direct losses and costs in the United States associated with the President's action; (4) an analysis of indirect costs and other adverse effects; and (5) a projection of the adverse effects in 1982-85 if a similar action were taken this year.

Analysis of the 1980 action has focused mainly on costs to the government and losses to the farmer in the months immediately afterward. This report deals principally with effects on certain economic sectors and the overall U.S. economy, as well as with costs borne by farmers and government.

1. The action: Suspension of grain and other agricultural product exports to the Soviet Union

The facts are simple enough. On January 4, 1980 President Carter ordered an indefinite suspension of shipments of agricultural products and some other goods to the U.S.S.R. The principal direct effect was to prevent the shipment of 13 million metric tons (mmt) of U.S. corn, 4 mmt of U.S. wheat, and 1.3 mmt of U.S. soybeans and soybean meal that had been sold to the U.S.S.R. for delivery before October 1, 1980. All but the soybeans were sold under terms of the fifth year of the United States-U.S.S.R. grain agreement. (Poultry and a few other agricultural commodities affected by the action are not considered here).

Grain shipments to the U.S.S.R. up to the 9 mmt that had been guaranteed by the United States under the Agreement entered into in 1975 were allowed to continue, both in the 1980–81 and the 1981–82 season. This accounts for the term "suspension" which was used in official government descriptions of the action, as distinguished from "embargo" which was commonly used outside the government. When the 8 mmt of grain that the United states had agreed to ship between October 1, 1979 and September 30, 1980 had been sent, the suspension became an embargo until October 1, 1981 when another 8 mmt was authorized to be sold and exported to the U.S.S.R. under the Agreement. Shipments of soybeans, broilers and some other agricultural products not under a trade agreement were embargoed from January 4, 1980 through April 1981 when the action was ended by President Reagan.

While the purpose of this report is to describe and estimate the effects of the loss of grain shipments, principally corn, to the U.S.S.R. in 1980, it also touches on soybeans. Soybeans are produced on the same farms as corn and in some cases wheat. They move through the same marketing system using the same transport and storage equipment. Therefore, conclusions drawn for grains apply directly to soybeans even though not all our estimates include soybeans.

The 1980 action affected the volume of United States-U.S.S.R. trade and overall commercial relations directly in all of 1980 and until April, 1981. The indirect effects continue to the present and will continue for an indefinite period. Their effects need to be taken into account and are treated here.

In describing the action and its effects, it is necessary to recognize economic linkages that go well beyond U.S. borders. When 13 mmt of U.S. corn, 4 mmt of U.S. wheat, and 1.3 mmt of soybeans and products could not be shipped to the U.S.S.R. between January and October 1980, the Soviets turned to Canada, Australia, and Argentina for grain. Argentina, which did not join with the United States in limiting grain shipments to the U.S.S.R., shipped additional quantities and was then unable to deliver the usual quantities to its regular markets. U.S. sales to some of those markets increased somewhat as a result. However, as discussed below, other exporting countries also responded to the larger market in the U.S.S.R., resulting from the U.S. embargo, by increasing total exports and later by increasing production.

While U.S. grain exports did not decline by the full amount of the direct 17 mmt decline in wheat and corn exports to the U.S.S.R. in the 1979–80 season, this magnitude of decline is probably not a bad estimate of the loss in U.S. exports in the two years following the January 4, 1980 embargo. For example, during the (current) sixth year of the United States-U.S.S.R. Grain Agreement beginning October 1, 1981 the United States has offered the Soviets 23 mmt of grain, but it appears that they will take only about 11 mmt from the United States. The U.S.S.R. purchased 16 mmt from other sources in 1979–80, 26.5 mmt in 1980–81, and will probably buy about 29 mmt from non-U.S. sources in 1981–82.

2. Moving U.S. corn, wheat, and soybeans into export markets

In this section, we will describe the industry sectors and government indicators that are most closely related to grain exports. Estimates of industry, government and general economic impacts are provided mainly in Section 3.

The amounts and percentages of U.S. corn, wheat and soybeans going into domestic and export markets for the two most recent years (1979–80 and 1980–81 marketing seasons) are shown below. Note that from 33 to 64 percent of production has been exported in recent years. Removing or substantially reducing such a large volume of exports to a major (sometimes the largest) customer is a critical matter with far reaching effects.

U.S. SUPPLY-DEMAND BALANCES FOR CORN, WHEAT, AND SOYBEANS, AVERAGE 1979–80 AND 1980–81 MARKETING YEARS

	Corn	Wheat	Soybeans[1]
Million metric tons:			
Production	185.3	61.3	55.2
Domestic uses	127.9	21.3	21.1
Exports	60.8	39.3	29.3
Million bushels:			
Production	7,294	2,254	2,030
Domestic uses	5,036	781	777
Exports	2,394	1,442	1,076
Percent of production exported	32.8	64.0	53.0

[1] Includes products on a soybean equivalent basis.

The principal economic sectors involved in moving agricultural exports on to their final destination are:

(A) *Inland transportation.*—Corn and soybeans move from production into export mainly from the Midwest, although some export corn originates in the Southeast and the Great Plains. Wheat moves to ports largely from the Southern and Northern Plains, the Midwest and Southeast, and the Northwest.

Roughly 55 percent of the grain and soybeans bound for export in 1980–81 moved to port by rail at a cost of about $.28/bu. from average locations to ports.

About 45 percent moved by barge at an average cost of $.20/bu., although a small amount moves by truck.

(B) *Ocean shipping.*—Less than 5 percent of U.S. grain and soybean exports are shipped on U.S.-flag vessels. Therefore, the estimate of lost ocean shipping receipts resulting from the 1980 trade suspension is for the world shipping industry rather than for the United States. Average ocean freight rates in 1980 were about $20/ton for bulk grain shipments from United States Gulf ports to the U.S.S.R.

(C) *Fertilizer, farm machinery, farm supplies.*—Effects of reduced exports on these sectors would be caused by:

Accumulation of large carryovers, leading to government programs to reduce acreage planted or intensification of such programs already in effect to reduce plantings by more than had been intended before exports declined.

Reduced market prices, leading to lower net farm income and diminished farmer purchasing power.

(D) *Labor.*—Reduced labor use in the transport, port loading industries and agricultural supply industries would provide the principal loss in this area from lower exports.

(E) *Balance of payments.*—Total U.S. farm exports were valued at $40.5 billion in 1980 and $43.8 billion in 1981, on a fiscal year basis.

Agricultural exports adjusted for agricultural imports are credited with contributing a net improvement in the U.S. balance of payments of about $25 billion as an average for 1980 and 1981, despite the reduced volume and the reduced value per unit of agricultural exports.

The year 1980, however, may have marked a turning point in U.S. agricultural trade results. For example, United States exports to the U.S.S.R. grew rapidly and fairly steadily during the 1970's, but fell sharply in 1980. Meanwhile, trade with Eastern Europe which was not affected by the embargo, continued to increase in 1980 and especially in 1981, when exports to the U.S.S.R. also recovered to about the 1976 level.

VALUE OF ALL U.S. EXPORTS TO U.S.S.R. AND EASTERN EUROPE

[Dollars in millions]

Calendar year	Total exports to U.S.S.R.	Agricultural exports to U.S.S.R.	Total exports to East Europe	Percent agricultural exports to U.S.S.R.
1971	$161	$45	$220	28
1975	1,833	1,170	1,279	64
1976	2,306	1,605	1,543	70

VALUE OF ALL U.S. EXPORTS TO U.S.S.R. AND EASTERN EUROPE—Continued

[Dollars in millions]

Calendar year	Total exports to U.S.S.R.	Agricultural exports to U.S.S.R.	Total exports to East Europe	Percent agricultural exports to U.S.S.R.
1977	$1,621	$1,053	$1,121	65
1978	2,249	1,765	1,454	78
1979	3,604	3,000	2,115	83
1980	1,510	1,208	2,421	80
1981	2,431	1,665	4,338	68

Source: Department of Commerce.

It is within the above framework of expanding trade with the U.S.S.R and Eastern Europe in the 1970's that losses in grain and other agricultural exports to those countries in 1980 and subsequent years, and arising from U.S. trade policy must be framed.

Another source of lost export earnings apart from the 18.3 mmt gross loss of shipments to the U.S.S.R or the net reduction in U.S. exports to the whole world, is the reduced value per unit of corn, wheat, or soybeans exported to other countries. In the next section we provide estimates of average price reductions per bushel or ton, resulting from the suspension or embargo action. These reductions affected the unit value of all agricultural exports subsequent to the embargo, not only in 1980, but as we shall show, in 1981 and 1982 as well.

(F) *Federal expenditures.*—Increased costs to the U.S. Government can never be fully accounted for since many thousands of man-hours, and much travel and communication were involved, taking time from other necessary government functions. The major tangible sources of increased costs arising from the suspension were:

Losses incurred in assuming most of the export contracts for grains, oilseeds, and other products that were canceled by the suspension action. USDA estimates this direct cost at about $465 million in the 1980 and 1981 fiscal years.

Costs incurred in acquiring, owning, and storing grain through increased loan and reserve entries, and direct purchases from farmers. As a result of the reduced prices and larger stocks associated with the embargo, the Commodity Credit Corporation of USDA (CCC) purchased abaout 150 mil. bu. of wheat and 155 mil. bu. of corn directly. We estimate also that about 200 mil. bu. additional wheat and corn went into the USDA grain reserve as a result of the embargo. Treating these outlays as costs is controversial since CCC will recover all or a large part of them. However, additional government outlays were made and must be counted.

Costs incurred in storing and owning the above additional commodities acquired by the CCC in the present case, for an estimated 3–4 years in view of the overall grain situation. Virtually all the grain purchased is still owned in 1982, and there is little prospect that it can be disposed of until 1983 or 1984.

Costs incurred in meeting target price payment obligations in 1980 or 1981 which were attributable to lower market prices, resulting from the embargo. No target price payments were made on the 1980 corn crop since a poor U.S. corn harvest kept all grain prices above target price guarantee levels. None were made in 1981, when U.S. policymakers unaccountably set the target and loan prices at the same level. However, target price payments of 15 cents per bushel on approximately 2.5 bil. bu. of wheat in 1981 must be attributed to the embargo in full or substantial part. Also, we estimate that average prices received by farmers in 1980 for corn averaged at least 15–20 cents/bu. lower than would have been the case without the embargo. Our figures show that average farm prices for corn until August 1981 were about 30–40 cents/bu. lower than if the United States had exported the larger quantities expected to be shipped in 1980. Without a suspension of trade with the U.S.S.R., we would not have had as large a carryover of corn at the beginning of the 1980–81 marketing year (1.6 mil. bu.), overall supplies would have been far tighter with the small crop, and prices would have been substantially higher to the present time or at least until the late summer of 1981. Wheat prices were reduced by an average of 25 cents per bushel over the two years.

3. Estimates of direct losses and costs

In Section 2 we described the linkages of farm produced grain to various economic sectors in and outside agriculture. In this section, we provide specific estimates of losses and/or costs incurred by the private sector and by government as a direct result of the 1980 suspension (later embargo) of certain exports to the U.S.S.R.

(A) *Reduced value of inland transportation.*—Losses to providers of rail, barge, and other transport for grains and oilseeds are estimated, based on composite freight rates provided in section 2, and on two levels of reduced exports: 18.3 mmt of lost exports, the gross amount by which United States shipments to the U.S.S.R. in the period January-October 1980 were reduced. Using this approach, the estimated loss in freight receipts mostly to rail and barge operators was $175 million; or 12 mmt, a rough estimate of the net amount by which U.S. exports of grain and soybeans to the world were reduced in 1980. This takes into account our increased exports to other countries that were the direct result of a rerouting of 3rd country exports to the U.S.S.R. and increased U.S. exports to their usual markets. The estimated loss in freight receipts in this case, where the loss in U.S.S.R. exports was partly offset, would be about $145 million. Judgments and claims on this matter will vary. Just after January 4, USDA and other offical spokesmen made representations that large amounts of grain no longer bound for the U.S.S.R. would be bought by Mexico. It is possible that Mexico bought some of the grain, but it is most unlikely that Mexico bought more than she would have needed from the United States.

(B) *Ocean shipping (world).*—Net losses in revenues in 1980 were either: $365 mil. based on the gross loss of export sales to the U.S.S.R.; or $240 mil. based on the net loss of export sales to the world.

As indicated earlier, less than 5 percent of this loss can be allocated to directly to U.S. flag vessels, although much more might be attributed to U.S. ownership and/or manning of foreign flag vessels.

(C) *Labor lost in transport and shipping.*—We have not estimated this directly, but include it with an aggregate estimate later in this section of the overall impact on labor and goods. The total loss in jobs throughout the economy was in the area of 310,000.

(D) *Balance of payments.*—The loss in export earnings from reduced shipments to the U.S.S.R. in 1980 was: Approximately $2.5 billion, based on actual export prices and the gross amount of reduced exports; or about $1.5 billion, if only 60 percent of the gross loss in exports is considered, in view of increased exports to other countries.

There is, however, another balance of payments cost that must be assessed—the reduced per unit value of U.S. grain export sales after January 4, 1980: (1) to all other countries in 1980; and (2) to all other countries in 1981. We estimate that the lower prices averaging 15-20 cents/bu. of corn and wheat in 1980 and 30-40 cents/bu. in the first nine months of 1981 affected roughly 3,600 million bushels of the two export grains in 1980 and 2,900 million bushels in 1981. Losses in exports from this secondary impact on the value of all exports were in the area of $540-$720 million in 1980 and $870-$1,160 million in 1981.

(E) *Government costs.*—In the previous section we identified about 505 million bushels of increased acquisitions of grain by CCC because of the trade suspension. The cost of these acquisitions is conservatively estimated at $1.5 billion.

Interest on $1.5 billion for the three years that these extra stocks are expected to be in CCC hands, at 12 percent amounts to $454 million. Extra costs for wheat target price payments made in 1981 were as much as $375 million.

(F) *The U.S. economy.*—The lost exports to the U.S.S.R. as a result of the January 4, 1980 embargo had a major impact on the total U.S. economy. Agricultural production and exports generate jobs and incomes far beyond farming itself—in the agricultural input industries, in transportation and storage, in food processing, etc. For example, USDA estimates that every $1 million of production or exports of wheat, corn, or soybeans results in $5.2-$5.4 million in gross output of goods and services in the whole economy, including the farming sector.

The aggregate effects on the United States economy of the U.S.S.R. grain embargo are summarized in the following table. In making these calculations we used the season average prices of corn, wheat and soybeans that actually prevailed in the 1979-80 marketing year, prices well below what they would have been without the embargo, as indicated previously. Using these prices tends to underestimate the losses involved, but the magnitude of the loss in income to the U.S. economy is so great that one can treat it conservatively without loss of effect.

On the other hand, we assume that the full 18.3 mmt of grain and soybeans affected by the embargo represents lost exports over two seasons. As discussed earlier, this probably overestimates the loss in actual exports in 1980, but is a reasonable representation or an underestimate of the two year loss in exports.

The effects of the 1980 embargo on the U.S. economy are estimated as follows, based on the Commerce Department's input-output model of the U.S. economy and the gross reduction in exports: A loss of $11.4 billion in output of goods and services—0.5 percent of national output; reduced employment equivalent to 310,000 workers, or 0.3 percent of total employment; and a reduction in personal income of $3.1 billion, or 0.1 percent of total.

Note in the table below that the impacts are listed separately for corn, wheat, and soybeans.

IMPACT OF LOST EXPORTS TO U.S.S.R. IN 1979–80 ON U.S. ECONOMY

	Season average farm price (dollar per bushel)	Lost export volume (millions of bushels)	Lost export revenue (millions of dollars)	Nationwide losses in—[1]		
				Output (millions of dollars)	Employment (number of workers)	Personal income (millions of dollars
Corn	$2.52	512	$1,500	$6,863	189,630	$1,806
Wheat	3.78	147	646	3,014	79,508	856
Soybeans	6.28	48	301	1,568	40,635	445
Total			2,447	11,445	309,773	3,107

[1] Based on Gerald Schluter and Kenneth C. Clayton, "Expanding the Processed Product Phase of U.S. Agricultural Exports," NED, ERS, USDA, July 1981.

4. Indirect costs and other damage to U.S. agriculture and the economy

Prior to the January 4, 1980 suspension of grain sales and shipments and the accompanying political strains between the U.S. and U.S.S.R., American farmers had been and were expected to remain the principal suppliers of grain and soybean meal to the U.S.S.R. This is evidenced by the record of grain shipments from the 1971–72 through the 1978–79 season, as shown below. While our exports to the Soviets did not maintain the spectacular level of 1972–73, they did increase in the seasons indicated. This is especially true if we consider the low level shipped in 1971–72 of 2.9 mmt of U.S. grain. U.S. shipments were far greater than shipments by all other suppliers combined in most years after 1971, until the year of the embargo.

(A) *The U.S. has now become the residual supplier to the U.S.S.R.*—The commercial relationship in grains developed with the U.S.S.R. during the 1970's represented a sharp change in the U.S. role in the world's grain trade, compared with our position vis a vis other importing nations. For a number of reasons arising out of the nature of grain marketing procedures and government policies in other countries and from some past U.S. farm policies, the United States has often been the residual supplier of wheat and coarse grains to the world. This is more true in the case of wheat than of corn, but it is true of both sectors. All other suppliers would sell whatever they had available in most years, and the United States would supply the remainder to a waiting world.

With the U.S.S.R. the United States was the favored suppler and other countries got the residual trade—until 1980. This situation developed both from the large quantities of grain Russia needed in some years; their experience in getting such quantities readily from the United States; and their lack of confidence in getting large quantities from other suppliers.

The predominance of U.S. shipments is seen in the fact that we supplied between 55 and 75 percent of U.S.S.R. grain imports between 1972-73 and 1979-80, after having only a 37 percent share in 1971-72.

U.S.S.R. WHEAT AND COARSE GRAIN IMPORTS, BY SOURCE (JULY–JUNE YEAR)

[Million metric tons]

	1971–72	1972–73	1973–74	1975–76	1977–78	1978–79
United States	2.9	13.7	7.9	13.9	12.5	11.2
Argentina	.1	.1	.3	1.4	2.7	1.4
Canada	3.0	5.1	1.8	4.5	1.9	2.1
Australia	.5	.9	.1	2.0	.3	.2
EC	.1	1.9	.5	.5	.2	.1
Other	1.2	.8	.3	3.4	.8	.1
Total	7.8	22.5	10.9	25.7	18.4	15.1

That favored relationship no longer exists and is not likely to be re-established. The United States is now the residual supplier to the U.S.S.R.

The contrast of the previous record with the export record since the 1980 suspension action and expectations for the 1982–83 season is dramatic and discouraging. This is illustrated in the following table, showing that the U.S.S.R. imported 26.5 mmt from non-U.S. sources in the 1980–81 season and will import 29 mmt of grain from those sources in the 1981–82 season. At a minimum, the Soviets can probably buy 26–30 mmt from the rest of the world year-after-year in the early 1980's (as shown in the Table for 1982–83).

U.S.S.R. GRAIN IMPORTS, BY SOURCE (JULY-JUNE YEAR)

[Million metric tons]

	1979–80	1980–81	1981–82	Projected 1982–83
United States	15.2	8.0	11.0	0–6
Argentina	5.1	11.2	12.0	11–12
Canada	3.4	6.9	8.5	8–9
Australia	4.0	2.9	2.5	2–3
EC	.9	1.1	2.5	2–3
Others	1.8	3.9	3.0	2–3
Miscellaneous grains (all sources)	.6	.5	.5	.5
Total	31.0	34.5	40.0	25.5–36.5

(B) *The U.S. may lose all exports to the U.S.S.R. in some years.*—Optimists may say that the U.S.S.R. has imported 31-40 mmt in each recent season and will inevitably need to come to the United States for large tonnages each year. In fact, recent years have been unusual years, in comparison with the 1970's. The 1979, 1980, and 1981 Soviet harvests fell short of their official targets which averaged 233 mmt by 25 percent, or some 59 mmt per year. A shortfall as large as 59 mmt per year was unusual, even for the U.S.S.R., where farm production is notoriously unstable.

Such seasons will happen again, possibly soon. However, there will also be fair to good seasons when U.S.S.R. grain production is 200–215 mmt and fine seasons when production may exceed the 1978 record. When such seasons occur during the early 1980's, there is little reason to expect the U.S. to sell much or any grain to the U.S.S.R. As shown in the tabulation below, the Soviets could harvest as little as 190 mmt in 1982 or 1983, maintain feeding at or near their recent high levels or probably well above their 1981–82 level (if the 1981 harvest was well below 175 mmt), and import only the 26–30 mmt available from the rest of the world.

CURRENT AND PROSPECTIVE U.S.S.R. GRAIN BALANCE

[Million metric tons]

	Total production	Imports	Total use	Feed	Stocks
1980–81	189	34.5	225	119	+2
1981–82:					
(a) USDA	175	42.0	216	120	0
(b) Low	155	40.0	194	97	0
1982–83:					
(a) High	215	26.0	229	122	+10
(b) Medium	200	29.0	226	120	+5
1983–84:					
(c) Low	190	30.0	220	115	0

This possibility shows how misleading it is to argue that U.S. grains alone, or grains plus our limited exports of other products, can exert material and sustained political leverage on the U.S.S.R. Only when Russia's needs are extraordinary (greater than 26–30 mmt per year) and/or when supplies from other grain exporters are unusually low could the United States alone exercise great leverage by cutting off agricultural exports and that would probably be only temporary. This is not to say that a U.S. or a joint U.S.-allied trade embargo would not damage the U.S.S.R. Rather, it suggests that damage would be sporadic and limited most of the time.

With the support of all the other major grain exporters or in years following very poor U.S.S.R. crops and high import requirements, the United States would have some political leverage on the U.S.S.R. However, it should be remembered that U.S.S.R. meat consumption at half the U.S. level, is not so low as to generate serious problems if meat suppliers were reduced or could not be increased. The option of reducing meat consumption targets in the U.S.S.R., cutting off or reducing the need for large and constant grain exports, is also an option for the U.S.S.R. In fact, some argue that this is how and why a grain embargo should be used to force a reduction in diet quality, leading possibly to internal discontent and political disruption.

(C) *A doubtful future for the United States-U.S.S.R. grain agreement.*—The 1975 Agreement under which the U.S.S.R. agreed to buy at least 6 mmt U.S. grain and the United States agreed to sell and deliver at least 8 mmt per year through September 1981 was in part a logical successor to the "stop and go" U.S. trade actions of 1973–74–75. The United States stopped or stalled exports of grains and/or oilseeds on three occasions in those years, once to the world and twice to the U.S.S.R. or Eastern Europe.

The United States-U.S.S.R. Agreement grew out of these actions since it both reassured the U.S.S.R. that we would ship certain minimum amounts and reassured the United States that our farmers could count on a certain level of export sales. The United States initiated and pressed the 1975 talks that led to the Agreement, even though the popular wisdom was that "Russia needs us more than we need them." It was a diplomatic event, negotiated largely by the Undersecretary of State, not an agricultural event. The United States has offered the U.S.S.R. large quantities of grain above the 8 mmt level each year, at out initiative and without ever having a formal request from the U.S.S.R. for more grain.

This result was partly a matter of form; the United States is more open than the U.S.S.R., and our grain supply levels are well known. Our officials would wait for the Soviets to ask, during a consultative meeting, for the grain we were sure they needed. Eventually we offered it unilaterally in most cases.

Even though the Soviets have now learned that they can buy 25–30 mmt of grain per year from non-U.S. sources, some advantages remain for them to buy as much U.S. grain as possible, however. We are more certain than any other country to have large exportable supplies in a bad year; we carry most of the world's reserves; and we can perform better than most other exporters on shipping schedules.

In 1982, however, there are very few reasons for the U.S.S.R. to want a new agreement with the United States. The U.S.S.R.:

Has agreements with most other grain suppliers.

Can get all the grain and oilseeds it needs in many years without buying in the U.S. market, as shown above.

Can buy in the U.S. market at any time (barring a general export embargo) without an agreement.

Is unlikely to want a grain agreement with the United States as a political action. The United States will have to beg to get into a new negotiation, although one or more annual extensions of the existing agreement might not be so difficult to arrange at our initiative.

(D) *Increased export capacity in other countries.*—Spurred partly by the strong demand for grains and oilseeds in the 1970's and by their own increasing grain output, Canada, Australia, and Argentina have increased their export loading capacity in recent years and are continuing to do so. This is illustrated by the total volume of grain shipped, as listed below. Note that Canada will export 7 mmt, or 41 percent more grain in the 1981-82 season than 6 years earlier. Australia will export 23 percent and Argentina 70 percent more than the 1975-76 season. These developments cannot be attributed solely or even principally to U.S. trade policies. But U.S. actions on agricultural exports have surely accentuated private and public actions and decisions leading to greater grain production and exports in other countries.

WHEAT AND COARSE GRAIN PRODUCTION AND EXPORTS FROM COMPETING EXPORTING COUNTRIES

[Million metric tons]

	Canada	Australia	Argentina
1975–76:			
Production	37.1	17.6	21.0
Exports	17.2	12.3	10.2
1980–81:			
Production	41.0	16.0	28.9
Exports	21.6	12.8	13.7
1981–82 est.:			
Production	50.2	23.0	25.3
Exports	24.3	15.1	17.4

Competing grain exporting countries have made major efforts to increase their production and export capacity, as follows:

Canada

Built a new export elevator on its west coast at Prince Rupert; invested heavily in hopper rail cars; and is attempting to modify its rail rate structure to improve its capacity to move grain by rail.

Argentina

Altered its grain policies to allow producers to receive world prices for grain and oilseeds in an attempt to spur production; and encouraged private firms to invest in inland grain origination and export elevator facilities and in soybean processing, much of which has been completed and more is underway.

Australia

Improved their export capability; and encouraged grain production through providing producers with higher advanced payments at the start of each crop year.

Even after adjusting for fluctuations in production and exports due to weather, competing exporting countries are already increasing their grain exports as the above table shows. These developments mean tht the U.S. faces growing competition from other exporters, especially in years when the U.S.S.R. is able to reduce its grain imports sharply from recent levels.

The U.S. role of a residual supplier may be further reinforced because the United States is the only major exporter that has explicit programs to support commodity prices and to reduce production through idling acreage in times of large supplies and weak demand. There is a real risk that U.S. price support levels will impair our price competitiveness in relation to other exporters.

The United States has also added substantial exporting capacity since 1975, much of which is idle in 1981 and 1982 because of the slowdown in exports, arising from limited shipments to the U.S.S.R., the general slowdown associated with economic recession abroad, and the strength of the dollar against world currencies.

5. Probable costs of maintaining the present de facto embargo or of an official embargo on U.S. exports to the U.S.S.R., 1982–85

Since early January, 1982, the Reagan Administration has been considering a general embargo against exportation of any U.S. products to the U.S.S.R. and possibly to Poland and other countries of Eastern Europe, to be applied under unspecified political conditions. These are generally thought to be: (a) more serious repressions in Poland than took place in late 1981 and January 1982; or (b) failure to lift martial law and begin to restore certain rights to the Polish people at an early date.

The President and others in the government have repeatedly stated: (a) that such an action would be taken only if it could not be avoided; and (b) that agriculture will not be singled out in any trade sanctions against the Soviet Union. Both these conditions are ambiguous, since the President can avoid such an action if he chooses, and because agriculture eventually will bear most of the costs of such an action.

It is inherent in the composition of U.S. exports to the U.S.S.R. that agriculture and especially grain is singled out by such an action. In recent years, our agricultural exports, mostly grains, have been about 80 percent of our total exports to the U.S.S.R. in value terms.

As a result, a general trade embargo is essentially a grain embargo. A few large U.S. companies, but no major industries apart from agriculture, transport and farm suppliers would be seriously endangered by a general economic embargo. The ultimate effects, of course, would spread throughout the economy as shown in Section 3.

Indirect, intangible, and future effects of both the 1980 action and its unofficial resumption in 1982 have far reaching implications for the United States.

The United States has become the residual instead of the principal supplier of agricultural products to the Soviet Union.

The United States may export only very small tonnages or perhaps no grain at all to the USSR in some future years under certain economic and political conditions.

It will be very difficult to negotiate a favorable U.S.-U.S.S.R. grain agreement in view of export availabilities from other countries.

Encouraged both by an expanding world grain market in the 1970's and by U.S. "stop and go" export policies, other exporting countries have increased both their transport and loading capabilities and their grain production.

A general trade embargo banning the export of U.S. goods to the Soviet Union in 1982 would almost inevitably cut off or seriously reduce this trade for many years. Such an action would be inherently an action whose direct impacts would fall principally on the farm sector and allied industries, since most of our exports to the U.S.S.R. are of farm origin.

If such an action prevented the shipment of 24 mmt or 945 mil. bu. of corn over three years, plus 12 mmt or 441 mil. bu. of wheat and 3 mmt or 110 mil. bu. of soybeans before it could be ended in (say) 1985, the overall economic costs would be as shown in the table below.

IMPACT OF LOST EXPORTS TO U.S.S.R. IN 1982-85 ON THE U.S. ECONOMY

	Nationwide losses in—		
	Output (dollars in millions)	Employment (man-years)	Personal income (dollars in millions)
Corn	$16,588	458,346	$4,365
Wheat	11,474	302,731	3,260
Soybeans	4,814	124,740	1,368
Total	32,876	885,817	8,993

U.S.S.R. GRAIN BALANCE

[Million metric tons]

Year beginning July 1	Supply				Disappearance				Stock change
	Production	Imports	Exports	Total supply	Total use	Food, seed independent	Waste	Feed	
Total grain:									
1977-78	196	18.9	2.3	213	228	77	29	122	−16
1978-79	237	15.6	2.8	250	231	78	28	125	+19
1979-80	179	31.0	.8	209	225	78	22	126	−16
1980-81	189	34.5	.5	223	225	78	28	119	−2
1981-82:									
USDA	175	42.0	1.0	216	216	79	18	120	0
Low	155	40.0	1.0	194	194	79	18	97	0
1982-83:									
High	215	26.0	2.0	239	229	79	28	122	+10
Medium	200	29.0	2.0	227	226	79	27	120	+1
Low	190	30.0	2.0	218	218	79	25	114	0

U.S.S.R. GRAIN BALANCE—Continued

[Million metric tons]

Year beginning July 1	Supply				Disappearance				Stock change
	Production	Imports	Exports	Total supply	Total use	Food, seed independent	Waste	Feed	
Wheat:									
1977-78	92	6.6	1.0	98	108	51	14	44	−10
1978-79	121	5.1	1.5	125	107	50	14	43	+18
1979-80	90	12.0	.5	102	116	51	11	54	−14
1980-81	98	16.0	.5	114	116	52	15	49	−2
1981-82:									
USDA	88	19.0	.8	106	106	52	9	45	0
SA	75	18.0	.8	92	92	52	9	31	0
Coarse grains:									
1977-78	93	11.7	1.0	103	109	21	14	74	−5
1978-79	105	10.0	1.0	114	113	22	13	79	+1
1979-80	81	18.4	....	100	102	22	10	70	−2
1980-81	81	18.0	....	99	99	21	12	66	0
1981-82:									
USDA	77	22.0	....	99	99	22	8	69	0
SA	70	21.0	....	91	96	22	8	61	0

Chairman GIBBONS. We will include in the record those attachments that you referred to, and I wish to commend you and your people for applying hard work with brainpower and going out and conquering the world markets.

Your trading improves the standard of living of every American, and we should be trading to improve our standard of living, not living to trade.

I am always impressed every time I pass by a farm; one out of every 3 acres of American farmland and machinery, and all of the other things used to produce that crop, are dedicated to export trade, because it is good business for America and good business for the rest of the world.

I applaud your position and your organization.

Mr. Bailey?

Mr. BAILEY. I get up here and sometimes comment on my experiences being a worker in the automobile industry, but I used to spend a lot of hours driving a plough, turning over a little dirt to plant a little bit of that corn, and, as a kid who grew up in that environment, I even have some fond memories of cleaning up chicken coops.

I remember working on that magneto.

I couldn't keep a new one.

In any event, I have some fond memories for the tremendous lesson that I learned spending part of my life growing up on a farm, and I will attribute it to the unmatched work ethic and commitment of American farmers.

People don't realize that an American farmer is just really in every sense of the word a businessman, a manager, long-term investor. He has to be an expert in finance.

He has to be an expert in markets, if he is going to survive, and I think our agriculture in this country is slightly incredible.

I want to say this about this legislation: I don't think it would cause the retaliation that you fear; I really don't.

The efficiency that you folks have attained. Remember the situation with twine? There was a big jump in cost about 10 years or so ago.

Mr. **Parsons**. Yes.

Mr. **Bailey**. You woke up one day, and you were paying $20 a roll.

Well, the point I am making is, you do exist with some Government help. Every governmental system in the world subsidizes the worst part of its agriculture.

I do not think we will do much more with this bill to get a lot of proper attention abroad.

I would not want you to think that people like myself, who come down on the druthers side of the legislation, are hostile to the fantastic job that you people do and your effectiveness.

You are going to be successful.

The Japanese are not going to buy less American agricultural products, because they suffer some lack of faith in America. They might sit back and say, those jokers are getting smart over there.

Let the record show that smile over there.

Chairman **Gibbons**. Was it a smile or a laugh?

Mr. **Bailey**. I don't think he was laughing at me.

Chairman **Gibbons**. You have gotten all those smiles in the record. I don't know whether they are laughing at you or smiling at you.

Mr. **Bailey**. Wall Street Journal, Thursday, September 30, 1982, by Urban C. Lehner, "How Japan Tries to Shut Out Foreign Goods", and this deals with an agricultural product.

Have you read it?

> A document from a Japanese government-owned corporation has surfaced in business circles here that provides rare, firsthand evidence in writing of Japanese attempts to shut out foreign products—something foreign businessmen and officials have long alleged but have rarely been able to prove. Indeed a broader look at the controversy underlying the document provides a case study of the kind of elaborate web of restrictions the Japanese can weave when they're determined to have their domestic market to themselves.
>
> The document came out of the Japan Tobacco & Salt Corporation (JTS), a government-owned monopoly that exercises exclusive control over all tobacco-products distribution in Japan. U.S. officials and the three American tobacco makers who sell here through the JTS have long believed and have at times formally complained to the Japanese government that the monopoly tries to obstruct foreign cigarette sales.
>
> The document could well become a cause celebre in the ongoing efforts of the U.S. and Europe to persuade Japan to open its market to foreign products. The Japanese government has been trumpeting the claim that it's doing everything possible in that respect. But the document, a six-page battle plan detailing how one of JTS's local offices in Tokyo was to carry out its sales and promotion activities last July, specifically orders steps to squelch foreign cigarette sales.
>
> "Curb stocking of imported cigarettes in vending machines," the document says at one point, indicating further that no foreign brands should appear in small machines containing fewer than 10 columns of cigarettes.

I won't take any more time in reading the rest of the article. It is very supportive of the hypothesis presented here. This is symptomatic, giving rise to the frustrations and the reason why this bill was brought forward.

[The article referred to follows:]

[From the Wall Street Journal, Thursday, September 30, 1982]

HOW JAPAN TRIES TO SHUT OUT FOREIGN GOODS

(By Urban C. Lehner)

A document from a Japanese government-owned corporation has surfaced in business circles here that provides rare, firsthand evidence in writing of Japanese attempts to shut out foreign businessmen and officials have long alleged but have rarely been able to prove. Indeed a broader look at the controversy underlying the document provides a case study of the kind of elaborate web of restrictions the Japanese can weave when they're determined to have their domestic market to themselves.

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"Curb stocking of imported cigarettes in vending machines," the document says at one point, indicating further that no foreign brands should appear in small machines containing fewer than 10 columns of cigarettes.

RETAILERS WON'T TESTIFY

"Remove displayed POP (point-of-purchase promotion) items for imported cigarettes in prominent locations," it say. (The American makers say many Japanese retailers have told them that JTS salesmen tear down posters and other promotional materials for foreign cigarettes. But they say the retailers won't testify to that because they depend on the JTS for licenses to do business and for a continuing supply of tobacco products.)

A JTS official involved in drawing up the battle plan confirmed that the document is authentic. A JTS spokesman declined direct comment because he hadn't seen the document. But he said "it's unlikely" that JTS would tear down promotional material or change the brands in vending machines "without the retailers' consent."

The document emerges at a time when officials in Washington are showing increasing displeasure at what they regard as Japanese foot dragging in carrying out earlier promises to open their market. The Japanese government earlier this year announced two packages of measures aimed at removing obstacles to foreign products, and missions of Japanese Dietmen have come to the U.S. to tout the measures. But U.S. officials say most of the measures that Japan announced with such fanfare have yet to be carried out. And a reading of the JTS document and talks with the American tobacco companies suggest that in the case of the JTS at least, new "impediments" are being thrown in the path of imported tobacco products every day.

Promoting the success of cigarette sales here is especially important to Washington, because cigarettes are one product that U.S. officials believe could easily make a significant dent in Uncle Sam's enormous ($18 billion last year) trade deficit with Japan. Cigarette sales come to a staggering $5 billion a year here, and U.S. cigarettes have proved very competitive in other foreign markets. Moreover the JTS, sole manufacturer of Japanese domestic cigarettes, is hardly a tower of business strength; there are moves afoot in the Japanese government to dismantle the monopoly because of its inefficiency.

"If American made cigarettes were allowed to gain just 10 percent of the Japanese market," argues Philip Morris International, one of the American makers, in a position paper, "the imbalance in trade would be reduced by half a billion dollars."

But as it stands, foreign cigarettes claim only 1.4 percent of the Japanese market. They're hindered in getting a bigger share by innumerable legal restrictions—even forgetting about such underhanded measures as those outlined in the JTS document. For example, under Japanese law and JTS regulation, foreign cigarette makers:

May sell their products through only 20,035 of the 247,801 Japanese retailers licensed to sell tobacco products. (As one of the measures announced earlier this year, that number is scheduled to rise to 40,041 by next March 31 and to all of the retailers by March 31, 1986. But the American makers say JTS is carrying out the measure in a way designed to minimize foreign sales as long as possible.)

Sell their products subject to a 35 percent tariff and to a tax and pricing formula, which combined with the tariff causes foreign cigarettes to sell at a retail price 60 percent above domestic Japanese brands. That's true even though the price of American cigarettes when they land in Japan is about the same as the factory price of the Japanese cigarettes.

Are sharply limited in their ability to advertise and test-market their products.

Must distribute their products solely through their chief competitor—the monopoly JTS. "There's no way your principal competitor is going to help you," says Joel Silverstein, Japan representative for Brown & Williamson Tobacco Corp., another of the American makers.

John Sandor, who runs Philip Morris's operations locally, complains that JTS never seems to have enough of Philip Morris's products in stock to meet orders from retailers. For example, he says, when retailers order Lark, Japan's best-selling foreign brand (Japanese smokers favor "charcoal filters" like the one Lark features). "The monopoly will normally indicate that a sufficient number aren't in the warehouse and a competing domestic product—in the case of Lark, Cabin—will be partially substituted."

The JTS internal document suggests that the monopoly uses a variety of subtle tricks to hold down foreign sales. For July in Tokyo's Sumida ward, the document ordered special emphasis on sales of five domestic brands. one of them was Marlboro (though a Philip Morris brand, it has been produced by JTS under license here for over 10 years). According to Tsuyoyuki Asaka, one the JTS officials who helped draw up the document, Marlboro was chosen because it's considered an effective domestic "rival brand to counter imported brands."

Then there are the not-so-subtle tricks, like tearing down or stopping the posting of foreign posters, advertising displays or the electrically lit "light boxes" placed on top of a vending machine displaying the name and logo of a brand. R.J. Reynolds Tobacco International, a subsidiary of R.J. Reynolds Industries Inc., complained several months ago to the new ombudsmen's office that JTS salesmen were telling retailers they weren't legally allowed to display promotional material for foreign brands. The case was settled when JTS agreed to inform retailers in writing that such materials could be displayed.

Then in early August a retailer in Tokyo's Shibuya section informed an American maker that a JTS saleman appeared to have taken away the retailer's "light box" atop the vending machine. But when Japanese government investigators acting on a complaint from the maker that didn't name the retailer, blanketed the area to interview retailers, no one mentioned the JTS. Missing light boxes were blamed on other causes—one was said to have blown away in a typhoon. The moral the investigators drew was that Americans make reckless allegations without proof.

U.S. officials and cigarette makers drew a different conclusion: Retailers are so vulnerable to the JTS pressure, explicit or implicit, that they can't afford to testify against the monopoly. There is at least some evidence that JTS doesn't shrink from using pressure to get its way with retailers.

Some retailers themselves make the same point. "Sure there's pressure (not to use foreign cigarette posters)," says Hinako Nakajima, a tobacco-shop owner in Nagoya. "The government hasn't abolished the monopoly system." Asked if JTS salesmen have ever forcibly removed posters from her shop, she will say only "please don't make me answer that question."

BLITHELY UNCONCERNED OFFICIALS

David Guilfoile, R.J. Reynold's Japan country manager, says Reynold's agents talk at least once a month to a large percentage of the 4,300 retailers in Tokyo licensed to sell foreign brands, "and the most common problem is the retailer will say, I can't allow you to put up that (poster or light box) because the JTS will get upset." Mr. Guilfoile says Reynolds hesitates even to complain about such abuses to the government because "we end up getting the retailers we're trying to develop as customers into trouble."

Japanese officials, for their part, seem blithely unconcerned with the tobacco question. Before one of the Dietmen's missions went to the U.S. a few months ago, one of the Dietmen was asked about tobacco at a special press conference for foreign correspondents. He replied that Japan's cigarette maker was "completely free" and thus there was nothing to discuss with the U.S. government.

Nonetheless, in the second package of measures the Japanese did come up with some tobacco concessions. They agreed that the U.S. Japan "study group," which had been scheduled under the November 1980 Japan-U.S. tobacco agreement to be formed by March 31, 1983, will convene instead next month, an acceleration of six months. It isn't clear what scope the study group will have, however. U.S. officials say the Japanese have agreed to put the tariff question "on the agenda" but haven't agreed to negotiate a lower tariff.

It also isn't clear how meaningful the other concession in the second package—the increase in the number of retail outlets—will prove in the short run. U.S. Officials and makers complain, for example, that all the outlets the Japanese have unilaterally selected to be included in the increase to take effect next March are outside the two regions of Japan where 60 percent of the foreign cigarettes are currently sold. That means the foreign makers won't be able to get more bang out of the sharply limited television advertising dollars they're allowed to spend, which by necessity are concentrated in those two regions.

"That isn't the way you'd do it if you were operating in the spirit" of opening the market, Mr. Silverstein contends.

Mr. BAILEY. I know, as I was reading, I didn't get one of those smiles either at or for what I have just read there. I would invite you to look at the rest of the article, and peruse it. I do want you to know this bill is not designed to cause you problems.

Mr. PARSONS. What was the publication of that again?

Mr. BAILEY. The Wall Street Journal, not a very well-known source, Thursday, September 30, 1982.

That is today.

Mr. PARSONS. I might ask our legislative man to comment on that.

Mr. HEJDUK. Mr. Bailey, we certainly recognize the situation that exists in terms of trade barriers in Japan and also in the European Economic Community and other countries.

The situation as we view H.R. 5133, it is really a double threat in terms of how the impact may be on U.S. agriculture, not only in terms of what retaliatory actions may in fact occur if it were passed. But even the threat of 5133 or the passage of it would certainly make it more difficult, as we view it, to negotiate resolutions to the trade barriers that currently exist, for U.S. bulk corn and for meats that certainly affect the price of corn in this country.

Mr. BAILEY. A lot of folks are getting tired of waiting. They want a few better results. It indicates during a time when the Government was telling us that they were doing everything they could, behind the scenes there was a deliberate total deceptiveness, and that is exactly what that says, that it was an official Government policy by a Japanese-owned monopoly, and there are a lot of accusations in other areas.

You folks do a tremendous job and have been in the business of growing corn, and we can make it even better for you.

I am starting to voice to you some of the complaints of those who do feel threatened. There should be a more open situation here. That is the real point of the legislation, but I understand your point of view, and I do respect it.

Thank you very much for presenting it as well as you have.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. Thank you very much for your testimony.

Of your annual production, what percentage do you sell abroad?

Mr. HEJDUK. About 30 to 34 percent, and roughly one-third of the corn crop is exported.

Mr. FRENZEL. What would you export?

Mr. HEJDUK. In view of the corn farmers' situation, the corn farmer would like to produce as much as the market could take. Given the situation that we see domestically with growth becoming not stagnant, but at least little growth, certainly a profitable opportunity for corn farmers exists in the export market.

Mr. FRENZEL. What would your opportunities be abroad if corn were to pass some sort of sanctified contract?

Mr. HEJDUK. The National Corn Growers certainly are on record, certainly, in support of sanctity of export contracts, citing the situation that existed in January of 1980, and roughly 17 million tons of grain that certainly was under contract, the majority of that grain under contract was not allowed to be delivered to the Soviet Union.

As a result, we know the impact that had on U.S. market prices, and U.S. corn prices. We certainly do support the concept of sanctity of contracts, and have worked on behalf of it.

Mr. FRENZEL. It ran a few farmers out of business?

Mr. HEJDUK. It certainly did, Congressman.

Mr. FRENZEL. I appreciate your statement. It is important to know that some of these bills are trying to relieve problems that exist in certain areas for a variety of reasons often affect other areas.

You need not be abused to support the original sufferer. Your testimony is well-taken. There is no reason why your folks should be further abused.

Chairman GIBBONS. Thank you. We appreciate your coming.

Our next witness is the Director of the Institute for International Economics, Mr. C. Fred Bergsten.

I notice you have a colleague.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS, ACCOMPANIED BY HOWARD ROSEN

Mr. BERGSTEN. Yes, Mr. Howard Rosen.

Mr. Chairman, I understand that one of the issues that has arisen on numerous occasions during these hearings has been the question of the exchange rate relationship between the dollar and the yen, and the effect that that may have on the problem before you.

I submitted, several days ago, an extensive study I have done.

Chairman GIBBONS. We will place that in the record.

[The information follows:]

[News release 1982:3, Institute for International Economics]

BERGSTEN CALLS FOR COMPREHENSIVE GLOBAL RECOVERY PROGRAM

WASHINGTON, September 29.—The dismal outlook for the world economy and the threat of international monetary and trade crises require urgent launching of a comprehensive global recovery program. Dr. C. Fred Bergsten made this assessment in an address to the National Press Club today. Dr. Bergsten, Director of the Institute for International Economics, was Assistant Secretary of the Treasury for International Affairs from 1977 until January 1981.

Dr. Bergsten notes that the continuing stagnation of the world economy is being intensified by a downward spiral of world trade, the debt overhang of the developing and East European countries, and huge misalignments between the dollar and other major national currencies. Taken together, these developments pose a severe threat to the entire world economy and to the United States itself.

Dr. Bergsten argues that an international response to these problems is essential because no individual country, acting alone, is able to break out of the global stagnation. Only global recovery will permit satisfactory economic expansion in the United States. Conversely, no foreseeable US recovery would suffice to restore a satisfactory level of global growth. In addition, the several international aspects of the current crisis are susceptible only to a coordinated policy response.

To deal with the crisis, Dr. Bergsten recommends a six-part program:

(1) Reorienting the thrust of macroeconomic policy in the major industrial countries, cautiously but surely, in the direction of expansion.

(2) Doing so through coordinated action among the major nations, with the specific mix of policies tailored to the unique situation of each so as to assure the needed stimulus, to avoid erecting new international imbalances, and to minimize the risk of failure for each individual country.

(3) Launching a new round of international trade-liberalizing negotiations at the Ministerial Meeting of the General Agreement on Tariffs and Trade (GATT) in November to reverse the increasing trend toward protectionism.

(4) Reforming the international monetary system to avoid sharp currency misalignments such as exist at present by developing a system of "target zones" for exchange rates and a mechanism to keep rates within these zones.

(5) Positioning the International Monetary Fund to handle the debt crisis by agreeing immediately to raise its quotas to SDR 100 billion and creating an "emergency fund" of at least SDR 20 billion.

(6) Expanding by 50 percent the lending programs of the World Bank, which can obtain its resources from the international capital markets and assure effective policies in developing countries, to pick up part of the financing gap that will be left from the debt-induced reduction in the flow of private credit to those nations.

Dr. Bergsten argues that only the United States can take the lead in launching such a program. He urges that it do so immediately to avoid severe risks to itself and to the world economy as a whole.

PREVENTING A WORLD ECONOMIC CRISIS: WHAT MUST THE UNITED STATES DO NOW?

AN ADDRESS PREPARED FOR DELIVERY TO THE NATIONAL PRESS CLUB SEPT. 29, 1982

(By C. Fred Bergsten, Director, Institute for International Economics*)

THE GLOBAL ECONOMIC PICTURE

The American economy is dead in the water. Unemployment is the highest in four decades. More than 30 percent of all factory capacity lies idle. Agricultural income is the lowest in fifty years. Bankruptcies are the highest since the Great Depression.

There are few signs of recovery. Virtually all forecasts are being steadily revised downward. Neither the tax cuts of July nor the recent decline in short-term interest rates has stopped the slide. Real long-term interest rates remain at stratospheric levels.

There is clearly a risk, even a probability, of continued flat or very low growth over the next couple of years. Even those bold enough to foresee a recovery expect it to be the most anemic in the postwar period—and increases of 2-3 percent in GNP, even if they were to eventuate, would do little or nothing to reduce unemployment and stem the tide of financial disruptions. Even so, these estimates are much more likely to prove too optimistic rather than too pessimistic—as has been the case with virtually all forecasts over the past year or so.

The entire world economy is in the same dismal shape. The other major countries—Japan, Germany, France, Britain—are also largely dead in the water. They face record postwar levels of unemployment and somber outlooks. As a group, the industrial countries in 1982 are experiencing their third straight year of low or zero growth.

The developing countries are in even worse shape. Their dynamic expansion made a major contribution to the world (and US) economy for the past two decades, but in

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*Assistant Secretary of the Treasury for International Affairs, 1977–January 1981; Assistant for International Economic Affairs to the Assistant to the President for National Security Affairs, 1969–71.

1981 their economies grew less rapidly than their populations for the first time in over twenty years. Key developing countries, such as Brazil and Korea, have experienced sharp GNP declines. Even the most buoyant nations in the world, such as Malaysia and Singapore, are seeing their still-positive growth rates cut in half by the global slump.

Beyond these gloomy economic aggregates lie other equally worrisome indicators:

World trade is declining for the first time in the postwar period and protectionist pressures are active in virtually every country, conjuring up images of a downward global spiral as in the early 1930s.

Exchange rates of the major currencies, most notably the dollar and yen, are as far out of line with underlying economic relationships as when similar misalignments destroyed the Bretton Woods system of fixed exchange rates in the early 1970s—conjuring up images of renewed international monetary turmoil and currency gyrations.

The debt burden of the developing and communist countries exceeds half a trillion dollars, and a growing number of debtors are falling behind in their payment of both interest and principal—conjuring up images of widespread default and worldwide financial crisis.

To be sure, there is some good news as well. Inflation is down almost everywhere—though the reduction in observed inflation in the United States substantially exceeds the reduction in underlying rates, which so far amounts to no more than 2-3 percentage points.[1] Energy prices are again trending down and the current glut is increasingly viewed as a lasting phenomenon; indeed, the next jolt in this area could be a "reverse oil shock" of sharply declining prices, with salutory effects on world inflation and growth (through disastrous consequences for Mexico and other oil-producing countries and companies). Short-term interest rates have come down substantially.

But none of this good news has yet done anything to restore a viable US or world economy. Nevertheless, economic policy in almost every country remains riveted on fighting inflation. Virtually all calls for change seek tighter budgets. Such an approach is endorsed by each successive international gathering of officials, most recently the Versailles Summit and the annual meeting of the International Monetary Fund in Toronto. So the forlorn picture remains, raising three basic questions:

Is the world heading toward a new depression and/or a financial collapse of major proportions?

Is there an alternative set of policies which could significantly minimize such risks, and even promise a return to stable growth?

Can the United States restore acceptable economic growth at home without worldwide recovery?

AMERICAN DEPENDENCE ON THE WORLD ECONOMY

There are reasons to doubt that the United States can achieve satisfactory economic performance without a sharp improvement in the world economy as a whole. Evidence is growing that both the secular slowdown in growth over the past decade and the cyclical slump superimposed on it over the past two or three years are global rather than national phenomena. The much noted slowdown in US productivity growth, for example, is only the American component of a widespread international shift—productivity growth in other key industrial countries, including Japan, has fallen further than in the United States.

Moreover, no major country—including the United States itself—has been able in recent years to expand successfully in a stagnant world. The US effort of 1977-78 was choked off within 18 months by mounting external deficits and the fall of the dollar in the exchange markets. The Mitterrand effort in France, a year ago, foundered even more quickly. Korea and Brazil, the fastest growers in the world during the 1960s and 1970s, were forced into sizable downturns in 1980 and 1981. Mexico, the fastest grower in the world over the past five years, is now being forced to retrench. With the possible exception of very small nations, which can maintain export expansion by increasing their market shares even in the face of global stagnation, the scope for purely national recovery now appears extremely limited.

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[1] For example, the Federal Reserve Bank of New York attributes 3-4 percentage points of the decline in recorded US inflation, i.e., at least half of it, to the sharp rise of the dollar in the exchange markets. Since the dollar is now substantially overvalued, this rise must of course cease and thus end its contribution to lower inflation. In addition, however, it will at some point also reverse course and decline—thus promoting sharper price rises at least for a time. See Robert A. Feldman, "Dollar Appreciation, Foreign Trade, and the U.S. Economy," Federal Reserve Bank of New York Quarterly Review, Summer 1982.

This situation creates an ironic paradox for the United States. The traditional view, still held in many quarters, is that world recovery depends on US recovery. To be sure, it remains difficult to imagine a substantial world recovery without a substantial US recovery. But neither can the rest of the world simply sit back and wait for the United States to lead them back to stable growth; any increase in US industrial production produces only about one-third as much expansion in the rest of the OECD, and even the fairly robust US recovery in 1976-78 did not revive much activity elsewhere.

At the same time, it now appears that US recovery depends importantly on world recovery. The reason is simply that the US economy has become inextricably linked with the world economy: Over 20 percent of US industrial output is now exported; about one of every six US workers in the manufacturing sector owes his job to exports; two of every five acres of US farmland produce for export; almost one-third of all US corporate profits derive from the firms' international activities, including their foreign investments as well as their trade; and the share of trade in our GNP has more than doubled over the past decade.

U.S. dependence on the world economy can be seen even more clearly at the margin than in these structural data. From 1978 through 1980, about 60 percent of the total growth in the US economy derived from the sharp improvement in our external balance. From early 1981 through mid-1982, the deterioration in the (real) external balance was the largest single factor—larger than the slumps in the housing or auto industries—pushing our economy into recession.[2]

It is thus clear that US policymakers must contemplate a global strategy if they are to have much hope of restoring satisfactory economic performance in the United States itself—a reversal of almost 180 degrees from the approach of the past 20 months, and of a substantial degree from all previous experience. Such efforts would focus, of course, on the other industrial countries—especially Japan and Germany and, to a lesser extent, the rest of the Common Market and Canada. The strategy would have to include the developing countries, however, both because they have the potential to again provide a major stimulus to world growth and because, under current circumstances, they pose the greatest threat of triggering a global crisis.

IS A CRISIS AT HAND?

There are three ways that the underlying stagnation of the world economy could produce a full-fledged global crisis. In ascending order of severity, these are (1) the threat of trade conflict akin to the interwar period, (2) the exchange rate problem and generalized international monetary instability and (3) the debt problem, with its attendent risks for the financial system at both the global and national levels. Each of these problems is extremely serious in its own right but it is their cumulative impact and the inter-relationships among them that further intensify the perilous nature of the overall situation.

World trade is highly sensitive to the growth of the world economy. when economic activity in the OECD countries is rising by more than 1.5—2 percent per year (all countries in real terms), the non oil imports of those countries (which account for about 70 percent of world trade) tend to grow about three times as fast. Under such circumstances, which prevailed throughout the postwar period until quite recently, there is a virtuous circle between economic growth and trade: increased growth stimulates even faster growth of trade, which stimulates more economic expansion and so on. This process has been an important element of postwar prosperity, in stark contrast to the downward spiral of trade that deepened and broadened the Great Depression.

When OECD growth dips below 1.5 percent, however, a similar negative cycle takes over because OECD (and hence world) trade then tends to decline at a multiple of the shortfall in growth. When OECD business activity is flat, for example, non oil trade tends to decline by about 5 percent. Such a fall in trade further erodes national economies, producing a further decline in trade, and so on. We are now witnessing just such a negative spiral.[3]

Such a situation, of course, fosters sharply increased pressures for trade restrictions—which would steepen the downward spiral. European and many developing countries have been erecting numerous new import barriers. Japan's import regime is a source of major frustration everywhere, though it is probably easing somewhat under massive global criticism.

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[2] See C. Fred Bergsten, "The Villain is an Overvalued Dollar," Challenge, March/April 1982.

[3] These relationships are develoed in C. Fred Bergsten and William R. Cline, "Trade Policy in the 1980's: An Overview of the Problem" in William R. Cline, ed., "Trade Policy in the 1980's" (Washington: Institute for International Economics, 1983 forthcoming).

Perhaps the best measure of the depth of these pressures, however, is the behavior of the current US administration. Despite its clear devotion to market principles, including free trade, it has taken significantly protectionist steps in four major industries during its first 18 months in office (which far outweigh its liberalizing actions on shoes and televisions sets): The imposition of "voluntary" restraints on Japanese auto exports to the United States; severe tightening of the Multi-Fibre Arrangement, which governs most international trade in textiles and apparel, and subsequent tightening of its bilateral agreements negotiated within that framework; introduction, and subsequent tightening, of import quotas for sugar; and negotiation of a new "voluntary" restraint agreement on European steel, which would de facto cartelize the world steel market (and, fortunately, has thus far been rejected by the US steel industry in its quest for even more stringent controls).

Indeed, the United States, which must take the lead in any successful international effort to avoid a breakdown of the (still relatively) open trading system, seems to be intent on fighting at least a two-front trade war instead. The battle continues to rage against Japan, including threats by the Congress to pass legislation embracing the so-called "reciprocity" approach and requiring specified local content percentages in all automobiles sold in the United States—either of which would reverse decades of successful U.S. trade policy.[4] The latest opponent is Europe, on issues ranging from agricultural subsidies through steel to the Siberian pipeline. And the advance developing counties have been put on notice to expect early expiration of their US tariff preferences—which, by adversely affecting their exports, would both dampen their imports (including those from the United States, for which they have been the most dynamic market for the past decade) and undermine the only possible avenue by which they might earn the foreign exchange to repay their debts to US and other foreign lenders.

There are numerous problems in international trading relationships, to be sure, and the other major countries—plagued by economic situations at least as difficult as our own—are not contributing very much to a constructive outcome. Like it or not, however, it is up to the United States to lead the way out of the morass and avoid the calamitous risk of a real trade war—and even a severe disruption of the entire trading system, which has been put together so painstakingly over the several postwar decades and has been a major foundation of the prosperity of that period.

Instead, as noted, the administration has moved in protectionist directions itself—undermining its own constructive proposals for a major new liberalizing initiative at the Ministerial Meeting of the General Agreement on Tariffs and Trade (GATT) in November. It has gutted the Trade Adjustment Assistance program, which since 1962 has provided government help for trade-affected workers and firms and without which—despite its failure to provide much real adjustment—continued U.S. adherence to liberal trade is difficult to imagine. It has undermined US exports by slashing the budget of the Export-Import Bank and tightening export controls for foreign policy reasons. And it has triggered the most formidable disincentive to exports and subsidy to imports faced by the U.S. economy in over a decade, the massive overvaluation of the dollar in the foreign exchange markets.

The international monetary threat derives largely from this severe misalignment of the exchange rate of the dollar against a number of other major currencies.

The most obvious example of this disparity, and the most serious in its implications, is the relation between the dollar and the Japanese yen. Over the past four years, the dollar has risen by over 40 percent against the yen. During that same period, U.S inflation (despite its recent improvement) has exceeded Japanese inflation, by 10 to more than 20 percentage points (cumulatively, depending on the measure used). The price competitiveness of US goods has thus deteriorated by over 50 percent against Japanese goods within a very short period of time. Any firm which suffered such a competitive loss would probably go bankrupt, yet the entire US economy has sustained such a loss. Can it be any wonder that there is a major crisis in economic relations between the United States and Japan, and that the Japanese trade surplus with the United States has soared to record levels?[5]

Against the world as a whole, the overvaluation of the dollar is probably on the order of 20 percent. On the basis of past relationships, this loss of price competitiveness alone could be expected to produce a deterioration of at least $60 billion in the

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[4] See William R. Cline, "Reciprocity: A New Approach to World Trade Policy?" (Washington: Institute for International Economics, September 1982).

[5] For details see C. Fred Bergsten, "What To Do About the U.S.-Japan Economic Conflict," Foreign Affairs, Sumer 1982.

US trade balance—pushing the merchandise trade deficit close to $100 billion and the current account into record levels of deficit, all other things remaining equal, and cutting over two percentage points from the GNP and eliminating perhaps two million jobs. As noted, the deterioration in the (real) external balance over the last year was already the largest single factor pushing our economy into recession—but we have so far seen only the tip of this particular, extremely costly, iceberg.

These international monetary relationships are obviously unsustainable. Indeed, misalignments of a roughly similar magnitude brought the collapse of the Bretton Woods system of fixed exchange rates a decade ago. Some of the current dollar overvaluation derives from the unstable world economic and political situation—on which the United States has only indirect influence. But the primary responsibility again lies with the United States: in this case, with the mix of huge budget deficits and very high interest rates which have sucked internationally mobile capital into the dollar and propelled it far beyond the level which can be justified on any reading of underlying relations between the United States and other countries.

Hence, the international monetary system is riding for major trouble because the dollar—still its key currency by far—is riding for a fall. One cannot say when that fall will come. But history demonstrates that it will come and, when it does, that the fall may be precipitous and severe. As noted already, a decline in the dollar is inevitable and, in some respects, desirable for the US economy and global equilibrium. But the effects of a plunging dollar on the world economy, and confidence therein, could easily deepen further the global slump. These monetary risks are especially serious when taken in conjunction with the threat of trade wars and the most urgent of all systemic risks, the debt crisis.

The international debt situation is obviously perilous, especially when (properly) seen in tandem with the growing number of bankruptcies and failures of financial institutions within individual countries. The developing countries alone owe over half a trillion dollars to foreign creditors. The East Europeans and troubled developed countries, such as Canada and Belgium, add substantially to that total. Outstanding loans by the nine largest US banks to Mexico and Brazil alone virtually equal their total capital and reserves.

There is great risk of extended non-payment of principal, and even interest, by a number of debtors simultaneously primarily because of—once more—the stagnant world economy. Indeed, today's global economic situation represents the worst of all possible worlds for international debtors: High real interest rates add enormously to the costs of servicing the debt; the world trade picture makes it impossible to earn enough foreign exchange from exports to repay, both because commodity prices are the lowest in at least 30 years and because markets for manufactured products are falling; the reduction in inflation limits the expected erosion of real debt burdens; and the deepening debt problem itself induces lenders to retrench as extensively as they can, so the flow of new money slows to a trickle and encourages domestic political opponents of current regimes to question the utility of continuing to play by the accepted "rules of the game."

These conditions have already forced an extensive list of countries to reschedule their debt repayments. A three-part procedure for doing so is well established, however, and avoids disruption of international financial arrangemens: the debtor country adopts a stabilization program which promises to restore its economy to a viable path, that program is blessed by the International Monetary Fund (IMF) and the private (and official bilateral) lenders reschedule and/or lend new money as needed.

Real problems arise, however, when any of these three components break down. For example, Poland is not a member of the IMF and thus there is no ready way to promote, endorse or monitor stabilization efforts there. The overriding question at the moment is whether Mexico and Argentina, the largest and third largest of all developing country debtors, will be politically willing to adopt the tough measures needed to restore financial stability. If they cannot do so, their currently modest arrearages on both principal and interest will reach sizable proportions quickly and the banks, presumably prodded by the supervisory authorities, will have no alternative to treating some of these loans as nonperforming and provisioning against losses on them.

Systemic problems could also emerge if the private banks were to cut and run, because this would render repayments all but impossible; rollovers, at a minimum, are a must. So far, even in the very difficult case of Poland, the banks have in fact avoided such a reaction. A much larger number of institutions are involved in Mexico, however, including a number without widespread international experience, so this aspect of the problem too bears close watching. And countries whose fundamental situations are in much less precarious shape are being sideswiped by the general seizing up of foreign lending; Hungary was hurt early this year by the spinoff from Poland and Romania, and Brazil is suffering right now from the impact of Mexico and Argentina.

Finally, the IMF must be in a position to play its role effectively. At its annual meeting in Toronto early this month, an opportunity to assure that it could do so was badly missed. The ministers there assembled should, at a minimum, have taken two steps to restore at least a modicum of confidence in their ability to foresee and prevent problems rather than simply react to them: an increase in Fund quotas to at least SDR 100 billion, from just over SDR 60 billion at present, and creation of an emergency facility of at least SDR 20 billion to tide the Fund over to the activation of that quota increase (probably in late 1985).[6]

The IMF, if it is able to work out agreements which permit Mexico and Argentina to exercise their full borrowing potential, will have very little money left. Under those circumstances, it would be unable to provide the temporary resources needed by major debtor countries and would lose much of its leverage to induce them to adopt effective stabilization programs. The ministers should thus have acted in Toronto. Unfortunately, as at the Versailles Summit in June, they commissioned more studies instead. Regrettably, US opposition blocked agreement on the quota increase—standing in sharp contradistinction to the alacrity, and effectiveness, with which the administration and Federal Reserve System put together nearly $4 billion in emergency credits for Mexico within a few days to avert the possible onset of financial panic in early August and proposed an "emergency fund" to help deal with such situations in the future.

Again, the problem underlying the debt situation is the state of the world economy. Any significant prolongation of current conditions will raise substantially the risk of payments moratoria. And moratoria by any significant debtors could have a demonstration effect on other debtors, or at least on opposition politicians in such countries, to emulate such behavior. A "debtors OPEC" is unlikely to emerge by design, but could develop via chain reaction.

Almost any conceivable resolution of the debt crisis will deepen the malaise of the world economy. Orthodox retrenchment by debtor countries to permit continued repayment or orderly rescheduling will, as in Brazil last year, further dampen world trade and growth. Non-payment of debt, on the other hand, would move the offending country's trade toward a wholly cash basis, as in Poland already, and substantially reduce economic activity directly—not to mention the effect of any such action by a major debtor country on overall foreign lending. Thus, from this vantage point too, the pressure on the world economy is in the downward direction.

A GLOBAL STRATEGY TO PREVENT A CRISIS

Three potential crises thus confront the world economy: A cumulative downward spiral of world trade and/or the outbreak of trade wars; a renewed outbreak of international monetary instability centering on a sharp and sudden plunge of the dollar from its unsustainable present level; and disruption of the international lending and repayment mechanism, with severe consequences for both national financial systems and the world economy.

These three problems are intimately interrelated. For example, the overvalued dollar is a chief source of protectionist trade pressures in the United States.[7] The decline in world trade makes debt repayment all the more difficult for strapped developing countries. So does the overvalued dollar, which drags up with it the currencies of many developing countries and thus impedes their export competitiveness.

All three problems add to the prospects of further downward movement in the world economy. At the same time, all three derive ultimately from global stagnation or from policies such as the erroneous U.S. fiscal-monetary mix which have caused it. If only one of these problems existed, it could perhaps be treated on its own without altering macroeconomic policy. Indeed, if none of these problems existed, one could perhaps argue for maintaining the anti-inflationary thrust of current macroeconomic policy in the hope that the further costs of wringing a bit more inflation out of the system would be acceptable. But the compound probability of severe difficulties, even disasters, from permitting all of these problems to persist without attacking their root cause is extremely high—especially when they are viewed, as they must be, at the global rather than the purely US (or other national) level.

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[6] See John Williamson, "The Lending Policies of the International Monetary Fund" (Washington: Institute for International Economics, August 1982).

[7] See C. Fred Bergsten and John Williamson, "Exchange Rates and Trade Policy," in William R. Cline, ed., Trade Policy in the 1980's, (Washington: Institute for International Economics) forthcoming.

The first element in the needed global strategy is thus to re-orient the basic thrust of macroeconomic policy, cautiously but surely, in the direction of expansion. The hour is late; the first changes in policy direction should be made immediately, as it will take time for specific measures to be adopted and more time yet for their effects to be realized. If events demonstrate the need for further change, it can be added later—and the authorities must be alert to the need to do so on a timely basis.

A prudent easing of monetary policy, especially in the United States both also in the major European countries (but not in Japan, because of exchange rate effects), has a central role to play in the new strategy. There are three basic reasons: its expansionary macroeconomic effects; the relative speed with which it can be implemented; and, in the case of the United States, its direct effects on the exchange markets and on the repayment prospects of the big international debtors. It can be left to detailed further discussion whether to achieve the needed easing by raising the targets for monetary growth, consciously overshooting those targets for awhile (as the Fed seems already to be doing to some extent) or by retargeting policy on real interest rates and other variables. But recent events here show that such a policy can bring down interest rates, demonstrating the fallacy of the "policy immobility" thesis which was widespread just a few months ago.

Fiscal policy will also have to play a role in the swing to stimulus, especially in countries other than the United States. Fortunately, budget deficits in most major countries are not unusually high (when adjusted for inflation and levels of business activity). At a minimum, planned fiscal tightening—with its perverse effects, in light of the economic situation both globally and in those countries themselves—should be postponed in Japan and the major European nations. Indeed, moderate fiscal stimulus is quite feasible in most of them without much fear of either arousing inflationary expectations or crowding out private borrowers. Fiscal policy in the United States is more complicated than elsewhere; it certainly should not be tightened further in the short run, given the dismal outlook for the economy, but tightening in future years may prove both necessary (to avoid a return to even higher interest rates) and easier to achieve (if the change in strategy produces faster economic growth and hence more government revenue).

Because it is essential to avoid boosting the underlying rate of inflation or inflationary expectations, and because any cyclical recovery will inevitably at some point push up the observed rate of inflation, the nature of the policy shifts must be carefully constructed. Fortunately, there is little likelihood of unleashing much inflationary pressure for some time with unemployment, capacity utilization and commodity prices (including for oil and food) at their current depressed levels. But the unique circumstances of each individual country will determine how it can best contribute to the overall strategy and every effort must be made to avoid rekindling problems on the price side.

For example, incomes policies should be introduced in those countries which do not now have them, such as the United States. Such policies are much maligned, and can certainly introduce distortions if applied rigidly over extended periods of time. However, they might prove able to consolidate the recent reductions in the underlying rate of inflation—and even promote further reductions in that rate. They might also help reduce some distortions in the current structure of prices and wages.

There are a number of specific approaches to incomes policies, many of which relate directly to market forces such as tax incentives. The critical importance of restoring economic growth without rekindling inflation, along with the effective implementation of incomes policies in several countries (including Germany and Austria and, for limited periods, the United States and United Kingdom), counsel efforts to seek effective ways to include them in any new policy package.

The needed strategy must be implemented on an international basis, at least among the major industrial countries. As noted, even the United States cannot singlehandedly escape from the global stagnation on a sustained and satisfactory basis; indeed, it failed to do so in 1977–78.

Each country would have to work out its own details, of course, and the precise policy approach would vary with the unique situation of each. A simultaneous thrust toward stimulus by the major countries, however, would both reduce the risks of failure to each and engender greater confidence that the whole program would work. International coordination of each country's policy mix would also be important, to avoid situations like the present anomaly whereby the United States and Japan are employing fiscal-monetary combinations more appropriately used by the other—with devastating effects on the yen-dollar exchange rates. In the monetary area, there may be scope for much more extensive cooperation among the major central banks to make sure that each of their policies are both effective and consistent. For example, U.S. monetary policy has been much tighter when viewed from a global perspective than solely in terms of the domestic monetary aggregates.[8]

Again, prudence will be necessary to avoid repeating episodes such as 1973 when excessive expansion in all of the major countries ignited double-digit inflation globally. But these recent lessons will surely help in avoiding such errors; indeed, they usually derived from a failure to coordinate macroeconomic policies internationally and buttress the case for pursuing such coordination in the future. The new international surveillance mechanism set up at Versailles among the five largest countries, with the active participation of the IMF, could provide a ready vehicle for developing and implementing a coordinated approach to restore the needed growth without triggering renewed inflation.

Beyond the shift in macroeconomic policy, several reinforcing steps will have to be taken to deal directly with the international dimensions of the current global malaise:

The history of trade policy suggests that it operates like a bicycle: either it moves forward to greater liberalization in the general interest, or it falls as individual protectionist pressures tend to prevail in seeking more controls. Hence, it is essential that the major countries put aside their current quarrels and use the GATT Ministerial in November to declare anew their commitment at the highest political level to an open trading system; resolve some of their immediate problems (such as agricultural subsidies and steel); and, most important, initiate a work program pointed toward launching as soon as possible a major new trade-liberalizing and rulemaking negotiation to deal with both old and new issues which will otherwise plague the world trading system in the 1980s and beyond. Needless to say, all major countries will have to start adhering faithfully to the precepts of an open trading system in deed, rather than solely in words—and implementing positive adjustment programs to enable them to do so.

Improvements in the functioning of flexible exchange rates could help avoid severe currenty misalignments, such as those which now exist, which levy such heavy economic costs on individual countries and threaten to plunge the entire international monetary system into renewed instability and even crisis. One promising approach would be to week agreement on techniques to define "target zones" for the relationships among major currencies, and methods—including direct intervention in the exchange markets, along with alterations in monetary and other national policies—to push rates back within such zones when they moved clearly out of line with underlying economic relationships. Such an approach could logically evolve from the group created at Versailles to study intervention policy.

To help cope with the dept problem immediate agreement is needed to enable the IMF to play its proper role by raising its quotas to at least SDR 100 billion and to create an "emergency fund" of at least SDR 20 billion both to tide the IMG over until implementation of the quota increase and to provide a strengthened backstopping mechanism in case a true debt crisis were to emerge.

Moreover, to accommodate the inevitably sharp cutback in the growth of private bank lending which is likely whatever resolution is found for the immediate debt problem, without further savaging the developing countries and the world economy, it is urgent to sharply increase the level of lending by the World Bank family. The Bank is uniquely positioned to acquire its resources by tapping world capital markets, with very little or on call on national budgets. It can insist on effective policies in recipient contries. Hence, it should raise its annual lending rate by about 50 percent for the next few years as part of the proposed global recovery strategy.

THE ROLE OF THE UNITED STATES

The comprehensive global recovery program proposed here is obviously ambitious. It would require a number of changes in policy in a number of countries—including the United States. But the gravity of the situation requires such a response. Anything less runs substantial risk of triggering one or more of the potential crises or, indeed, other forms of crisis which cannot now be foreseen but which could derive from the perilous state of the world economy.

It is virtually impossible to envisage implementation of such a program without active leadership by the United States. No other country (e.g., Japan) of group of countries (e.g., the Common Market) of international organization (e.g., the IMF) is equipped, at the present time, to launch such an effort. The fact that United States is to blame for an important part of the problem—through its faulty policy mix and extremely high real interest rates, its relapses into trade protection, its veto of a decision on IMF quotas in Toronto, its effort to limit World Bank lending—adds to the case for its seeking to lead the way out. But there is plenty of blame to go around, and the case for US leadership is simple: the situation is grave, decisive new action is needed, and only the United States can provide it.

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[8] See Ronald I. McKinnon, "Currency Substitution and Instability in the World Dollar Market," American Economic Review, June 1982.

Only the United States—under the Nixon and Ford administrations, with a central role played by the current Secretary of State—could lead in the creation of an international monetary system to replace Bretton Woods.

Only the United States—under each of its last five administrations—could take the lead in augmenting the resources of the IMF to deal with earlier international financial crises.

Only the United States—again, under each of its last five administrations—could take the lead in launching, and then successfully completing major international trade negotiations which further opened the world economy and held protectionism largely at bay.

The challenge now is much greater, because the response must include both a new direction for overall policy and new techniques for managing the world economy as a whole as well as its trade and monetary components. The conditions surrounding the effort are more difficult, given the dire conditions confronting the world economy. But the severity of these conditions requires the urgent launching of such an effort, and counsels that the United States seize the initiative to do so immediately.

Mr. **Bergsten**. Thank you very much.

I wish to make several points on more directly trade-related issues. The first point is to note, which I am sure you are aware of, but to emphasize it in this situation, in this context, that the world economic situation is right now extremely dangerous.

The American economy is dead in the water, and there are very few signs of recovery.

The world economy is in equally bad shape. All of this is compounded by an international debt crisis, big international monetary imbalances and these trade problems that we are talking about there.

I had the occasion to make an address yesterday to the National Press Club in which I tried to lay out these issues and suggest that the world was facing a very perilous economic situation right at the moment, and I would submit that to you if that was of interest.

Chairman **Gibbons**. If you have a copy of that, I would like to put that in the record, too. I only read a summary of it. I agree, if the summary is accurate, with what you have said.

Mr. **Bergsten**. I did bring a copy.

The point I wanted to make, in this context, is that the state of the world economy obviously helps to explain the problems of our own auto industry and remedies being proposed of the type that one has here, but I would suggest that in this situation, this perilous world economic situation, one of the worst things one could do would be to pass this kind of legislation.

I laid out in some detail in my statement yesterday the very important effect that the current decline in world trade is having on this world economic situation.

It is the first time in the post-war period that world trade is actually declining in volume terms, and it conjures up the same kind of downward spiral in trade that we saw in the interwar period.

We have done some careful analysis of the relationship between the world economy and world trade, and you get the following kind of simple relationship: whenever the OECD countries are growing in economic terms by more than 1.5 to 2 percent a year, world trade in volume terms tends to grow three times as fast.

That, in turn, of course, then promotes further growth in the countries which promotes further trade, and you have a virtuous circle of growing economic activity.

On the other hand, whenever OECD economic activity dips below 1 or 1.5 percent a year, world trade declines also at a multiple of the shortfall. When you get a situation now of roughly zero growth in the world economy, trade declines by about 5 percent a year.

Instead of the virtuous positive cycle, on the growing side, you have a negative downward spiral. It pushes trade and growth down further, et cetera.

If we were to come in with trade-restrictive devices which push this downward spiral further in a negative direction, it would help cascade this entire world economic situation in the wrong direction, and so, in addition to the points that I know have been made by many of your witnesses, I want to stress that this particular time when we are in such difficult straits, would be the worst time to put forward any kind of legislation of this particular type.

Indeed, to the contrary, it is particularly urgent to get the world trading system off the creeping protectionism that we are seeing, move back on to an opening course, support the efforts that the administration has been making for the GATT ministerial meeting coming up in November.

That meeting is of critical importance given the creeping protectionism.

If the United States were to take actions such as proposed in this bill, it would undermine any possibility for the United States to play the necessary leadership role to get the world trading situation back on the right course.

I would stress that argument, and commend it very much to your attention. A second point I would like to make is that in reading this particular bill, I was stuck by something that I have been struck by in looking at other proposals to restrain trade in the past.

That is, it really has no provision to use the time that would be bought or the help that would be provided for the industry in a constructive way for the industry to retool itself.

The auto industry is obviously doing a lot already in terms of increased investment, and working with its labor partners to try to deal with the wage side of the problem, but I am always struck that these proposals aim at temporary relief to give an industry time to improve its situation, but one never sees the other side of the equation, any requirements or provisions or supportive elements for the positive side of the adjustment process that absolutely has to occur, if one is going to utilize effectively any deviation from the normal reliance on market forces.

That point is particularly important right now when the longstanding trade adjustment assistance program has been gutted.

We all know that the trade adjustment assistance program did not provide much adjustment and that was one of the causes of its demise, but as I read the tendency now, it is to sit back and say that program failed and there is nothing we can do about it.

It seems to me that is a bankrupt concept, that without a program of effective response to these dislocation problems, we are not going to be able to maintain an effective international trade program.

I would commend to the committee, going beyond this particular bill, a major effort to examine the issue of how the U.S. economy can adjust to dislocations of this type, and find something to replace the trade adjustment assistance program if need be, but not just write the issue off.

Certainly, any proposal to give import relief to a particular industry should be coupled with a positive response, with adjustment in a lasting and positive way.

There is one element in this whole picture of international trade and investment in automobiles which gives me great concern, and where I have some understanding for the approach proposed in this bill.

That problem is simply that a number of other countries around the world do have performance requirements of this type governing the auto industries within their countries.

Now, fortunately, it is not any of the major industrial nations that have policies of that type right now. It is all developing countries whose auto industries are at a very early and developing stage, and no country with a mature industry like our own has this kind of policy at this time.

Many countries with rapidly growing competitive advantages do have performance requirements, something along the lines of the type proposed in this legislation; namely, thou shall create so much value-added domestically to be able to sell in the market.

That is a problem, growing in importance, affecting world trade and production of automobiles.

It is also creeping into some other industries and therefore, it is a growing problem. There are always, as in most cases of trade policy, two possible responses. You can either emulate that policy and say we will copy it and do it ourselves, or you can mount a massive effort to undo the other guy's policies.

The United States in the post-war period has always chosen the latter of those two approaches.

We have said that where there are barriers in other countries, be it in Japan or wherever, that the objective of our policy, which has served this country extremely well and quite successfully, has been to go after the barriers in the other countries.

I come back to the GATT ministerial in November. One of the issues Ambassador Brock and the administration have put on the table is the investment-related trade issue dealing with precisely questions like this.

Secretary Regan made a speech in London in May about a whole new set of rules to deal with these issues. That is an extremely important direction in which policy should move, but if the United States were to start copying what the others are doing, your effect would be to ratify what the others are doing.

It would give them blessing and encourage them to do more. As far as the ping-pong effect goes, we saw what happened when the United States induced the Japanese to put the voluntary restraints on 2 years ago. The result was that other automobile importing countries which didn't have restraints quickly put them on, and also those who had restraints already tightened the ones that they had, so it was a ping-pong effect, and that is what you always see in trade policy, and it would happen here, too, if you went down the local content route.

I do wish to indicate that is a problem, and it is terribly important to attack it on its merits and make a major move in the GATT and perhaps even more broadly to try to limit and eventually eliminate these kinds of practices which distort the world economy and hurt us in a national sense.

On the exchange rate question, I have been very pleased that your hearings——

Chairman **Gibbons**. Could I interrupt at this point? We have a vote on. I think what you are entering into now is most important, and I am going to recess the committee long enough for us to go vote and come right back.

I would like to hear your discourse on the exchange rate problem.

[Recess.]

Chairman **Gibbons**. Mr. Frenzel asked me to wait until he got back.

Mr. **Bailey**. Unanimous-consent request at this point, earlier I had read the four introductory paragraphs to an article in the Wall Street Journal, dated September 30, 1982, entitled "How Japan Tries to Shut Out Foreign Goods," by Urban Lehner.

I would ask unanimous consent that the article, which is really about a quarter of a newspaper page, be included in the record entirely.

Chairman **Gibbons**. Certainly, we would be glad to have it.

[The article appears at p. 657.]

Mr. **Schulze**. I am just reading it, and it is very informative. That is the way I view this legislation before us, retaliatory in nature, the only thing they are going to understand, because they keep doing things like this.

Chairman **Gibbons**. Mr. Bergsten, you were about to start on the points dealing with the exchange rate and the overvalued American dollar and the undervalued yen.

Mr. **Bergsten**. Thank you, Mr. Chairman. I was about to say how pleased I am that the committee has gotten into that issue in the repeated depth that I know you have so far in these hearings.

The reason I say that is because, as I have tried to study the history of U.S. trade policy throughout the post-war period, the exchange rate situation of the dollar turns out on my reading to have been the most important leading indicator of U.S. trade policy, more important than the unemployment rate and lots of other variables that one thinks about as being important in our trade policy.

The previous occasion up to now, when we had the most pressure for major import restrictions and investment restrictions was around 1970-72. The Mills bill passed the House and the Burke-Hartke bill was seriously considered, all of that in a period when the aggregate unemployment rate was fairly low but the dollar had become massively overvalued, creating huge trade and current account deficits and enormous losses in U.S. competitiveness.

U.S. organized labor had a point. They said our national economic position and policies were undermining their competitive ability. The proposed response was wrong, to try to come in with a lot of import barriers and such, but there was a real problem. It is not just theory that says there was a problem, there then had to be two major devaluations to put us back in competition with the world as a whole.

Once that happened, we were in good shape.

Chairman GIBBONS. It took a couple of years.

Mr. BERGSTEN. There is always about a 2-year lag between the competitive affects of an exchange rates change and it's finally playing its way through the order books and the actual shipments into the trade numbers and the effects on jobs here and abroad.

It did work out in almost classic textbook fashion. In 1975 and 1976, the dollar again became overvalued and that led to the record current account deficits we had in 1977 and 1978, but when the exchange rate was corrected and back in balance, we got an answer to the question that Mr. Conable raised with Mr. Wallis before.

Mr. Conable raised the question, is the U.S. economy in a fundamental sense competitive in world trade?

From 1978 to 1980, U.S. exports grew at twice the rate of world trade. By the end of 1980, the U.S. share of world export markets for manufactured goods was higher than it had been a decade earlier.

Over that 2-year period, 1978 to 1980, oil imports went up more than $30 billion. The current account position improved, by almost $40 billion.

Chairman GIBBONS. Go back through that again for clarification. What happened?

Mr. BERGSTEN. In 1977 and 1978, we had very large trade and current account deficits for several reasons, including the big runup in oil import prices and the fact that the U.S. economy was growing faster than other economies in the world, but also importantly, because the exchange rate of the dollar had become overvalued back in 1975 and 1976 for a variety of reasons I could go into later.

One result of all of that was then that the dollar, of course, weakened in the exchange markets and you remember the dollar crisis of that period, which I lived through quite actively in my responsibilities at the Treasury Department at that time.

The dollar weakened substantially, probably, in fact, overshot and weakened a little too much, but once the dollar exchange rate was back to an equilibrium level, which it roughly attained toward the end of 1978 or so, then U.S. trade competition blossomed and between 1978 and 1980 we had an improvement of about $70 billion in our current account position with the rest of the world, excluding the increase in the price of oil. Even including the price of oil, we went from a deficit of about $15 billion on the current account to a surplus at an annual rate of $10 to $15 billion, so there was an enormous improvement indicating that the underlying competitive position of the United States was very strong.

That occurred across industry categories and in practically every geographic market in the world. It was broad based and indicated clearly that the underlying U.S. position is, in fact, quite competitive in the world economy.

I am not saying there are no problems in terms of our own productivity or export promotion efforts. But I think that record shows that the underlying position was very strong, and as I say, one indicator is that our share of world exports in manufactured goods came back to the level that had been enjoyed in the late sixties, and around 1970, before the turmoil and losses in our market share and all that occurred in various times during the seventies.

So, that was an indicator that the underlying position was pretty good.

What has happened subsequently is that, again, the exchange rate has gotten way out of whack. From late 1978, the base period that I am using here, until now, the dollar has risen on a trade-weighted average against the other major currencies by about 30 percent.

Against the Japanese yen, the dollar has risen more than 40 percent. During that same period of time, unfortunately, U.S. inflation has been no better than that of the other major countries on average, and has cumulatively run about 20-percentage points more than in Japan.

Just to take the Japanese case that is the focus of your efforts now, over the last 3 or 4 years the dollar exchange rate has risen over 40 percent against the yen. Our inflation has been more than 20 percent greater than in Japan, and both those elements raise the cost of U.S. products vis a vis yen products, whether it is in our own market or in Japan or in Third countries around the world, the net result being that the price competitiveness of the U.S. economy as a whole has deteriorated by more than 50 percent against Japan in 3 to 4 years.

If any company had a loss of 50 percent in its price competitiveness against its competitors in a couple of years, it would be bankrupt. But our whole economy has sustained that amount of price competitiveness loss against the Japanese in world trade, both on the export and on the import side.

The United States has suffered a huge competitive loss as a whole, not quite as great as against Japan, but on the order of at least 20–25 percent on average in the world as a whole, so can it be any surprise that you here in the committee and in the Congress see industry after industry petitioning either you or the ITC or somebody for import relief?

They are being badly hurt. Is it any surprise that our export industries are complaining that they are having a rough time in world markets? They are because through the exchange rate relationships they are being priced out of a competitive relationship which as recently as 2 years ago was going extremely well. It is, therefore, quite logical that these changes in price relationship which derive from the exchange rate are a dominant feature of trade policy and trade policy concerns at any given point in time, but until your hearings began to unearth this, there has not really been much integration between traditional trade policy concerns with these monetary factors.

Certainly, within the U.S. administration at the current time, there is not much collaboration or coordination between the people who run international monetary policy, and the people who run trade policy.

I was struck by comments from the chairman of General Motors, and by the president of the National Association of Manufacturers in a letter to Secretary Regan submitted for your record. Both of them said that nothing is being done to even try to deal with this exchange rate problem.

That is correct, I am afraid.

Chairman **Gibbons**. My first question: Is there any force out there manipulating these exchange rates? Are the Japanese?

Mr. **Bergsten**. I don't think so. In the last episode that I mentioned, in the midseventies, they were. I know that for a fact because in some sense, I was the person who caught them doing it, using their hidden reserves to buy dollars in the exchange market to keep the yen from rising.

This was back in 1976, and when the Carter administration came into office, I traveled to Japan with Vice President Mondale in the very first week of the administration, and on the instructions of the President, indicated to the Japanese that we wanted them to get their hands off the exchange rate and let it rise, and follow market forces and therefore reflect the underlying competitive relationships of our economies.

That message was subsequently reinforced by the Secretary of the Treasury and others. To their credit, they did get their hands off the exchange rate and you can trace it.

The yen began to rise at that point. There was still big trouble in United States-Japanese trade relations for 1977 and most of 1978, as you will remember, but after the exchange rate move played through, the situation then became much, much better in 1979 and 1980.

We had the export boom that I mentioned. The Japanese current account swung into huge deficit, propelled in large part by the second oil shock, and our current account moved into surplus and our trade boomed.

At that time the Japanese, I think, were intervening illegitimately in the exchange markets. U.S. policy called them on it. They did retreat and the change took place.

This time, the situation is a lot more complicated. The yen is probably even weaker relative to the underlying forces now than it was back in 1976, and the reasons why it stays weak are quite difficult to fathom.

I do not find any evidence that the Japanese are directly manipulating the exchange rate at this point. Indeed, the Japanese this time have been intervening massively in the exchange markets to sell dollars and buy yen.

They have been spending billions of dollars over the past few months to keep the yen from weakening even further, so their intervention has been in the correct direction.

I wish that it would be supported by U.S. intervention, because cooperative activities in the exchange markets as we showed back in 1979 and 1980 can be extremely valuable in promoting and maintaining equilibrium in these economic relationships.

Now, it is U.S. policy not to intervene at all and that is a mistake, I think.

It is making the situation worse than it otherwise would be, but we cannot accuse the Japanese in any direct sense of manipulating.

Is there some indirect way through which they are keeping the yen weak? Again, I don't think so, but the argument is more complicated.

I am sure people before you have argued that Japan should open its capital markets further to foreign borrowers and that would help rectify the problem. I am afraid that is not right, at least in the short run, and in fact could even work the other way for the following reason:

If the Japanese opened their capital markets to American firms or others who came in and borrowed, what those foreign borrowers would do is borrow in yen and immediately convert their borrowings into dollars to invest either here or around the world, and it would have a perverse effect in terms of the problem we are dealing with by weaking the yen further.

The argument is that over the long run this would pull up Japanese interest rates so that the current imbalance between low Japanese interest rates and high U.S. rates, would be rectified. I just don't think it is true.

Japan, like any other big economy, basically manages its interest rates through its domestic monetary policy which should be managed with a much greater eye to international considerations than the Japanese have been doing, or that the United States has been doing, but I think it is a mistake to imagine that their opening their capital markets would have a dramatic effect on Japanese interest rates over time.

And in the short run, it would actually hurt the exchange rate situation. We are all in favor of liberalizing the Japanese capital market, but we have to recognize a structural asymmetry.

When Japan opens its capital markets, and assume it does so in full faith on both the outflow and inflow side, what is happening is that the Japanese change in policy would enable Japanese residents with their very high savings rates to have access to all those trillions of dollars worth of dollar and sterling, assets around the world that you can invest in. But when they open their markets to foreigners to invest in Japan, they are opening what is a relatively limited capital market in terms of yen assets that are available and attractive to foreign investors.

Even if their opening was completely symmetrical in both practice and principle, the net impact at least for some time to come would be net capital outflow from Japan.

In fact, there is a lot of foreign capital flow into Japan, but there are huge levels of Japanese capital outflow to the rest of the world, essentially exercising a pent-up demand that has developed over the course of a couple of decades, as Japan got richer, and they could not invest abroad, and now, it is being manifest in foreign investment and you get a net capital outflow to add further to the downward pressure on the yen exchange rate and in some sense explain it, and therefore, exacerbates the trade problem.

So I am afraid it is not an answer to ask the Japanese to open their capital markets further.

Indeed, what I proposed in that study was just the opposite, that because it was urgent for the yen rate to strengthen sharply, that

Japan should, for a temporary period, put very sharp restrictions on the outflow of capital from Japan and that the Japanese authorities should aggressively borrow abroad to bring capital into their country and strengthen the yen.

It is what the Japanese themselves were doing only 2 to 3 years ago when they were running huge current account deficits. They had to finance current account deficits as big as we ever ran and they did it basically by choking off very sharply capital outflow by Japanese citizens and citizens and by borrowing aggressively abroad.

Mr. **Frenzel**. 1979 and 1980?

Mr. **Bergsten**. In both years they financed them in the way I suggest now. They should now push the yen exchange rate up, because if the yen exchange rate does not quickly and dramatically rise in value, the problems you are facing today will look like child's play 1 or 2 years from now.

People worry that the Japanese bilateral surplus is now $18 or $20 billion. At these exchange rates, and assuming no further big rise in import controls, that number could go to $30 or $40 billion within the next year or two.

The global Japanese position could move into massive account surplus. It is estimated Japan's global account surplus will be $20 billion in 1983.

The current recession here is masking both the deterioration of our own position because imports are sluggish, and are the competitive position of Japanese exports.

Once we get a modicum of restoration of economic growth in this country, our trade and current account deficits are going to soar.

Maybe we are already seeing that in the August numbers, a record monthly trade deficit, annual rate of $84 billion. That is when the domestic economy is still dead in the water. When it begins to pick up, the trade and current account deficits are going to be in boxcar numbers, and therefore, raise to a much higher level of concern the problems that you are facing here now in the auto industry.

Likewise, when the world economy begins to pick up at all, the Japanese surplus will soar and the intensity of concern about Japanese exports here and in Europe and Taiwan and Korea, everywhere, will soar with them.

It is urgent to get this exchange rate moved in a very major way very, very quickly. That is easier said than done, and I would be the first to admit it.

It is a much more complicated problem now than it was 5 years ago, when we could say get your hands off the exchange rate, and market forces took it to where it wanted to go.

One would have expected the U.S. interest rates coming down to already weaken the dollar against the yen, but it hasn't happened. The yen has gotten even weaker.

Long-term interest rates here have not come off very much. There is still a pretty wide margin between our rates and theirs. And other factors, political and economic uncertainties around the world, are reminding investors of the safe haven virtues of the dollar and pushing money into the dollar for precautionary reasons, taking it out of all other currencies.

Given the state of the world economic outlook, that may continue for a while, and it would be a brave man who would predict that in the very near future, market forces alone are going to take the yen up. I would still submit it is urgent to do so, and that is why I make, for me, a strong supporter of market forces, a rather unusual proposal that the Japanese should move to very tight controls on capital outflow in order to push the yen up.

It is a third best solution, and by no means what you would prefer or like, but I don't see any other alternative. It is critical to get it moved, and I am delighted that you here have made that link to trade policy. I hope you help to do something about it because otherwise, the problems you face with the local content bill and other efforts to restrict imports are going to soar over the next couple of years.

Chairman GIBBONS. Let me make my position clear. When you face a real crisis, I am prepared to use crisis solutions to problems. You ought not to pick the worst possible solution to do it, and I think the domestic content proposal is probably the worst possible solution I have seen, because it is permanent.

We have other tools, a surcharge on Japanese imports again, simple quotas on their goods, or we could put tariff rate increases on their goods, which would probably be the least damage we could do to our economy, a simple tariff rate increase, so there are other tools available.

Of all the tools we have available, is the domestic content probably the worst tool?

Mr. BERGSTEN. I would certainly rank it pretty near the bottom of the list.

Chairman GIBBONS. All right.

If market forces are controlling value now, or accentuating the value, is there any great international conspiracy against the United States with our vastly overvalued dollar?

Mr. BERGSTEN. No, I don't think there is any conspiracy. In fact, the strong dollar is in many senses a strong vote of confidence in the U.S. economy.

It is the safe haven attraction of the dollar and the United States, under the current troubled situation in so many places in the world, that is pushing money into the dollar.

In one sense, you want to sit back and enjoy it and say that is a wonderful thing, a global vote of confidence in our currency, and makes it cheaper for us to buy imported goods and helps our fight against inflation, but at the same time, when it goes to the extent it does, it badly undermines our whole competitive posture in the world economy. On some rough estimates I have made, but supported by the Federal Reserve Bank of New York and others, it is costing us a couple of million jobs.

The implications of this overvalued dollar alone, in terms of what it costs our trade balance, and through that to our domestic employment picture, is enormously high. It is not a conspiracy, almost the opposite, but its economic effects can be devastating.

Chairman GIBBONS. As chairman of this subcommittee, I asked the Secretary of the Treasury this summer to please look at this problem. We have not had a response back. I have also asked the General Accounting Office to take a look at it.

I watch the dollar valuation decline in the newspaper every day and I am very concerned over what I see happening.

I have been, as you know, an admirer of yours and a follower of your ideas on this matter of dollar valuation for a long time.

I do remember the lesson of the 1970's, back when we took all kinds of actions, the so-called Nixon shocks, that poisoned the well enough that I still don't think we got the poison out of the well, and the Japanese still look at us with a terrible suspicion on what we did with them there, and that makes it terribly difficult to come in now and say, "Our hearts are pure, and our bodies are all clean, you all take another bath for us."

I don't want to emulate their success, and apparently the people that are betting on value of money don't believe the Japanese are heading in the right direction.

Mr. BERGSTEN. Well, you sometimes hear that. No one really knows why the yen is so weak now. There are lots of reasons. One reason that I should have mentioned is the fear of legislation like this local content bill passing.

Chairman GIBBONS. Even the investment in the United States is weakened there?

Mr. BERGSTEN. Some analysts think that lack of confidence in the Japanese outlook is part of the picture, as you suggest. They have a big budget deficit.

There is fear, of course, that legislation like this might pass or other protectionist measures adopted which chokes off their exports, does not enable them to use their competitive strength. But if one look at the history of the exchange markets over the last 10 years, since we moved to flexible exchange rates, one finds the markets always overshoot. They don't move as economists would like them to move; they go too far.

The dollar got too weak in 1978.

Chairman GIBBONS. The same thing with farm prices. Every time, you get a surplus or a deficit. Every market has its problems.

Mr. BERGSTEN. In one sense it is no surprise. All markets do it.

The difference is that the exchange rate has these critical implications for domestic economic developments, and when it gets way out of line, it has these major effects.

The yen has clearly overshot. What the history of flexible rate shows us is that at some point, some event will occur that will turn market psychology at which point the underlying forces will then assert themselves, and the bandwagon starts moving in the opposite direction, also, very fast, and probably shoots back in the other direction.

In the yen/dollar experience of 5 years ago, the yen rose 30 to 40 percent against the dollar in just about a year, 12 to 15 months then, to correct the misalinement existing at that time. So it can move very, very fast, and once the turn came this time, and the underlying forces which I think exist began to be reflected, you could get this kind of correction very quickly.

One hypothesis is that the U.S. economy begins to pick up somewhat modestly and the trade and current account deficits here do begin to move into big numbers, like the August number already showed, and the markets suddenly say there is a big swing here and start selling dollars.

The other side would be big Japanese surpluses so they buy yen, and that is basically what has happened on two or three occasions in the past.

Chairman GIBBONS. You are saying that current account deficit last month was not that bad?

Mr. BERGSTEN. It is a harbinger of things to come, not on a month-by-month basis.

The monthly numbers jump around enormously, but if you believe that the dollar is overvalued on an average basis by even 20 percent, which is probably conservative, the rule-of-thumb is that for every percentage point loss of price competitiveness our trade balance deteriorates by at least $3 billion over the 2-year lag you mentioned; so, if you believe we have a 20-percent overvaluation, you would expect around a $60 billion deterioration in our trade balance over the course of a couple of years.

That is 2 percentage points of our GNP, even though it is 3 trillion.

Now, over the last year, we have already begun to see a substantial deterioration in the U.S. trade balance. Normally, in a period like we have had with a deep recession here, the U.S. trade balance would improve sharply because imports would drop off, but over the last year the recorded numbers have stayed about constant, and there has been a big improvement in our terms of trade; our export prices have gone up and import prices gone down; our real trade balance has deteriorated somewhere between $10 billion to $15 billion.

It has helped push the economy into recession, and we have already lost $10 billion to $15 billion in real terms, big numbers starting to show up in August, but it is only a start of what is going to come certainly once the domestic economy picks up.

Chairman GIBBONS. I have been trying to think of alternatives here, if Mr. Bailey and Mr. Fraser could push me hard enough, I have to come up with some alternative. And I am trying to pick out the least of the bad alternatives, and they are all bad, but I am convinced that this is the worst.

Something like a rollback of Japanese imports, either through a quota, legislated quota that phases out, or a tariff increase that phases out, coupled with a wage-price freeze, a dividend prohibition, and coupled with the restructuring of the management of those companies while they rehabilitate themselves—I am hoping Bailey, Fraser and company won't push me that far. We have gotten to that stage right now with 230 cosponsors of this bill in the House; I don't know how much longer this can hang on.

Mr. BERGSTEN. I would comment only on one part of that, Mr. Chairman, because I know the pressures are great.

That is the part where you mentioned some increase in import restrictions on purchases from Japan.

Chairman GIBBONS. I had to do it on a phaseout basis during the rehabilitation period.

Mr. BERGSTEN. In that sense, the package meets one of the criteria I mentioned in my earlier remarks; that you have to have the positive adjustment side of any program if import relief is to provide any lasting benefits; so, in that sense, you have an internal consistency.

I would raise the following question, though: If the United States or the world as a whole were to raise new barriers against Japanese exports, one would think that might weaken the yen further.

Chairman GIBBONS. It would.

Mr. BERGSTEN. So that, in terms of their underlying competitive position, you would be moving in really the opposite direction.

Chairman GIBBONS. I agree.

Mr. BERGSTEN. Then the question has to be raised whether you would achieve anything, because, I mean—just take in very simple terms—suppose you put on a 15-percent import surcharge as we had in 1971, if the yen were then to weaken 15 percent further against the dollar, you have done nothing to improve the price competitiveness of American industry.

In practice, it does not always work out so neatly. In fact, if the objective of the exercise was to force a currency realignment as really was the objective in 1971, people might then take it as a signal that the United States was serious and really going to push the exchange rate, but if you just did it out of the blue, without making very clear that your ultimate objective was to get the exchange rate right, then you could not even wind up losing, on balance, because the yen might weaken more than your tariff increase, and then, if you increased your tariff a little more, the yen weakens a little more, and you are in a spiral.

It never settles, so the underlying objective of the exercise, and this is aside from your longerrun structural readjustment with wages and dividends, whatever, in terms of the United States-Japanese competitiveness, you would have to make clear that your overriding goal was to get the price relationship right through the exchange rate.

You were taking trade measures out of desperation, and that was your objective.

Chairman GIBBONS. I don't believe there is anything better than market forces to correct these things, but you and I have both criticized market forces, one as acting in the extreme sometimes, and they obviously do that.

If there is too much milk on the market, and the price of milk drops far below enough just to equalize the demand.

If you get too many eggs on the market, and conversely, a shortage of those supplies, and you go into all these other things, you get the same kinds of results.

We are very impatient people, and we expect instant results.

Government is the art of the impossible, and we are down to that now; but with all these cosponsors, and I believe many would like to get off the bill, but they can't do it gracefully.

Is there a better way than the market system?

Mr. BERGSTEN. Well, again, as we said a moment ago, the history of a lot of these markets that we have does indicate that for extended periods of time, they really can be out of whack with the underlying economic relationships.

You mentioned the commodity market; certainly that can be the case there as well. In the exchange markets, we clearly have a series of episodes now over the 10-year history of flexible exchange rates, of overshooting, where they clearly do go too far in one direction or another.

Rates get out of line and stay there.

This is by far the most serious episode we have had in terms of the extent of the overshooting and the duration of the overshooting, because the dollar hit levels roughly this high over a year ago, and has stayed there now for over a year, which means a continued drag on our competitive position.

In a situation like that, if you are convinced, as I am, that the level of exchange rates is really way out of whack with the underlying competitive relationships, then I think you have only two choices: You either say, we sit back and enjoy it, and simply throw up our hands at the ability to do better, and to bring these particular prices more in relationship with the underlying economics; or you look for admittedly second- or third-best options to do something about it.

I have stressed the possibility on the Japanese side of capital controls. There is a proposal with which we have some experience in this country, not terribly happy, of interest equalization taxes.

Chairman **Gibbons**. I remember that; yes.

Mr. **Bergsten**. There is a view that would say suppose there is a huge gap in interest rates between the United States and Japan and for good internal reasons, U.S. interest rates are 15 percent and Japanese interest rates are 5 percent, and that means money will move by the billions out of the yen into the dollar.

Well, you could put on an interest equalization tax charging 10 percentage points in that case on every investment that came into the dollar to equate internationally the effects of these different underlying national interest rates.

There are objections to that. You could raise lots of problems at the level of both principle and enforcement.

The United States had such an animal for 11 years, from 1963 to 1974, and in those days the interest differentials were much smaller.

We thought we had a big balance-of-payments deficit at that time. We had an interest equalization tax which covered only a limited range of capital flows, new security issues, some outstanding securities, and it was then subsequently extended to long-term bank loans, but not short term, and the experience was when you try to affect some portion of the capital flows, but not others, the money moves from the controlled to the uncontrolled channels and over time people get onto it, and there is not too much net effect over time.

The controlled sectors were affected, and significantly so, but the net balance was after a couple of years washed out because only a partial coverage was enacted, so you would have to be pretty comprehensive, and that raises lots of objections in principle and administrative practice.

Given the huge size of our capital market, in fact it would be much easier for other countries like Japan to do it; in fact, in their case I would even argue by administrative fiat rather than by a tax at all. There are devices, in short, that could be used for the purposes of the type we have in mind now. They are not very desirable and raise all sorts of problems, but maybe they are worth thinking about.

Chairman GIBBONS. Would an interest equalization tax be preferable to the proposals that I have made before?

Mr. BERGSTEN. They would be less bad.

Chairman GIBBONS. That is a fair way of saying it.

Mr. BERGSTEN. It would be less bad to consciously manipulate the capital account than to consciously manipulate the trade flows.

Indeed, that is even consistent with the IMF Articles of Agreement which have envisioned that it is legitimate to manipulate capital flows, but not to raise restrictions on the current account, even when a country——

Chairman GIBBONS. We could go into interest equalization tax without violating the GATT or exposing ourselves to retaliatory action through the GATT or through the IMF.

Mr. BERGSTEN. We could, but it would be a unique situation, because the United States would be moving from a position of a strong currency to try to weaken it, and you would have to be quite clear that people did not think you were, yourself, trying to reap an unfair competitive advantage and depreciate your currency, and all of that.

I think you could easily get an international consensus over a weekend that the misalinements needed some treatment, and that this was one way to go about it.

By contrast with the GATT situation, where you would be violating the law, and be subject to retaliation, you would be moving consistently with the international obligations that the country has.

Chairman GIBBONS. Any other better systems?

We discarded this bill, and some of the things that I have thought about; we have said that the exchange equalization tax, the interest equalization tax, is a least-worst-type solution.

Anything else we could do?

Mr. BERGSTEN. Well, there is nothing else that comes to mind immediately.

I would again come back, though, to the particular United States-Japan problem, and when you think of an interest equalization tax or any of those measures, you would have to do them on a global basis. If you did it to just a few countries, you would get leakage to other countries.

Then you ask the question, is the basic problem dollar overvaluation or yen undervaluation? There is a difference of opinion between the United States and Japan.

The Japanese largely agree with the kind of analysis that we are agreeing on here today. Most Japanese agree that the yen is substantially undervalued, and they would like to see it stronger. They would say that the great bulk of the reason for that is high United States interest rates, so, therefore, it is really up to the United States to take action.

If you view the problem as mainly Japan and vis-a-vis the world, then you might call on the Japanese to do an interest equalization tax or some quantitative capital controls of the type I have mentioned, to trying to strengthen the yen. That is where the difficulty in the real world negotiation and policy would come, trying to allocate the responsibility for the difficulty and who could most effectively and most fairly take remedial action.

Chairman GIBBONS. Given the complex way that we handle our monetary policy in this country, can you assess the responsibility respectively of the Federal Reserve and of the Treasury in this matter? I would like to hear you expound on that.

I am talking about domestically and as it impacts upon the trade situation that we have before us.

In other words, while we look toward the Secretary of the Treasury, and we have requested responses from him, should we also be looking at the Federal Reserve?

Mr. BERGSTEN. It is hard to assess responsibility in that sense.

Chairman GIBBONS. I am not trying to put blame, but trying to find the right valve.

Mr. BERGSTEN. I understand.

Chairman GIBBONS. Should I twist one or both?

Mr. BERGSTEN. I was going to say both, but maybe one a little more.

As far as the conduct of monetary policy, itself, goes, the administration, with a little sniping on specific points, has been fully in support of what the Federal Reserve has been doing over the last 18 months, so you have on monetary policy per se a common responsibility, if you want to put it that way, and in that sense one should address them both.

In addition, though, I think the administration does bear an additional responsibility because of its budget policy. The fiscal policy we have had, over these last 18 months, the very sizable level of budget deficits through the foreseeable future, has put further pressure on interest rates and with a given level of monetary policy in the sense of the monetary aggregates you have raised interest rates to a level much higher than they needed to have been. The big fiscal deficits have put pressure on the financial markets, and expectations of continued high budget deficits way out into the foreseeable future, even when the economy was again to pick up, raise the crowding-out theory. So, what you have had is this rather strange fiscal-monetary mix of what amounts to a rather loose fiscal policy, and, therefore, quite tight monetary policy in terms of interest rates given the underlying level of the monetary stock growth.

You can operate, of course, at any point in that equation in terms of policy. You can say, ease up on the monetary side in order to bring interest rates down and avoid some of this dollar overvaluation, and you can say, get the budget deficits down at least in the outyears to take some of the pressure off interest rates and let them decline even with monetary policy staying where it is in terms of the aggregates.

You need some of both.

The recent bill which went through the Congress and began to rectify the loose fiscal policy has been a helpful contributor in bringing interest rates down, at the short end, in the last couple of months, and probably more of that is going to be necessary at least for the outyears, not right away, because of the weakness of the real economy.

At the same time, the Federal Reserve has, over the last few weeks, let the monetary supply grow at a higher level than it had been earlier, a bit above its own targets, and that is probably constructive.

We probably need some further reduction in interest rates to deal with the really calamitous domestic economic situation that underlies all of this.

In addition, if that were done, it would help, one hopes and believes, to deal with this exchange rate problem we are talking about, so I think responsibility really lies in both the monetary and the fiscal policy authorities, and both have to do some further changing in attitudes, although one can be at least modestly encouraged because there has been a revealed change in the attitude to some extent on both, due to the tax bill you passed this summer, and some modest expansion of the money supply faster than it had been growing in the recent past.

The simple answer to your question is, you better talk to both of them, because they both have a big role in this situation.

Chairman **GIBBONS**. How urgent do you think the situation is?

Mr. **BERGSTEN**. I think it is very urgent. I think what a lot of people are missing is the cumulative nature of the financial problem with bankruptcies and near-insolvencies every week, high unemployment, missing the exchange rate effect on all of this, and missing the international dimension. Every major country is dead in the water.

The developing countries are plummeting. Brazil's economy declined 5 percent last year. Mexico is going to have to go through it now. Korea went through a massive recession in 1980 and early 1981 as a result of all of this.

Looking at it on an international basis, and cumulating the underlying economic problem with this negative trade spiral, with the financial problems, I think the hour is late, and it is time to take some fairly dramatic action in all these areas to get off the dime.

Mr. **FRENZEL**. Would the chairman yield?

Chairman **GIBBONS**. Certainly.

Mr. **FRENZEL**. Mr. Chairman, I am going to be obliged to leave. I wanted to tell Mr. Bergsten how much I have enjoyed his testimony and wish I could participate.

I have always been an admirer, not always a follower, but I found the conversation fascinating, and I would like to pick it up at some later date, perhaps on top of a mountain with several bottles.

Warnings you give are very pessimistic, require some kind of action, some kind of concerted action, and I am really pleased that you brought us this message.

I apologize for having to leave.

Mr. **BERGSTEN**. I fully understand, and thank you very much for your comments.

Chairman **GIBBONS**. On the dollar world currency ratio, because we have increased in value against every currency, it used to be acceptable to talk about the difference between a crash landing and a soft landing. Where are we headed—for a crash landing or a soft landing?

Mr. **BERGSTEN**. That is a very hard question.

The history of flexible exchange rates, unfortunately, does not carry too many cases of soft landings or smooth paths of adjustment.

As I said before, the exchange rates overshoot with what is called the trade bandwagon effect. Everybody says the dollar is strengthening, and I make a good turn overnight, and if I am a corporate treasurer, I can convert at the end of the quarter and make my profit statement look good.

So I get into dollars and the bandwagon rolls, and it rolls beyond any kind of underlying balance point, maybe a large amount, and it tends to stay there or keep rolling until some event comes along that really turns the tide.

In 1978, concerning the dollar weakness, we in the Treasury knew for some time that the fundamentals had turned in favor of the dollar from the early part of 1978.

Our trade and current account deficits hit their peak in the first quarter. By the time we did the November rescue package, the $30 billion support package for the dollar, we had 6 hard months of evidence that our position was improving very substantially, but the dollar continued to plummet downward in the exchange markets, and only when we put together the $30 billion rescue package, and a 1-percent reserve in the discount rate, were we able to stabilize the situation and begin the turnaround of the dollar.

A lot of the answer, the answer to your question, really depends on how it happens. What will be the event that comes along that suddenly reminds people that these underlying fundamentals are quite different than are being reflected in the exchange markets right now?

Maybe in the case of the deutsche mark, it might be the election of a new government which inspired confidence and took all sorts of investment-boosting moves to sharply improve the German economy again.

There has been a lot of uncertainty about their political situation. In Japan, it is hard to tell. I don't foresee any event of that type at the moment. It could be a publication of 3 or 4 months of trade numbers like we just saw for August. If numbers came in for a few months running, people will say there is a change in the fundamental competitive positions, and that says something about currency values, and we better act on that.

The markets, which we sometimes think of as great predictors in this area, clearly are bad predictors and lag substantially.

The history of exchange rates shows that without much risk of contradiction; so really the question is, what is the event or series of events that come along and trigger a change in the underlying recognition of fundamental versus more transitory factors?

If we got further disruption in international financial markets and political uncertainties, such as in the Middle East, that could strengthen the dollar a good deal more, the safe-haven attraction could pull further capital into the dollar and it could go to 300 yen in the short run; so it could go in either direction.

Eventually it will turn; some major event or policy shift, or accumulation of results will change it, but then it would tend probably to go very fast back in the other direction.

That is at least the record historically; so this, then, conjures up a different kind of instability and uncertainty, as the rates began to move in the other direction. That has been my fear, in fact—that since the dollar has stayed over valued now so much for so long, that when the turn eventually comes, it could go very fast and be very steep, and though a change is clearly needed—the way it happens could be very disruptive.

In 1977 and 1978, the dollar exchange rate had to come down. Secretary Blumenthal talked in terms of strengthening the yen and the mark, and it was clear there had to be exchange rate changes to put things back into balance.

The change had to come, but, unfortunately, in part because of the Japanese intervention in 1976, in part for other reasons, and partly because of the lag in market perceptions, it came at a great rush, and so, instead of correction of underlying imbalances, which we tried to get in the first 6 months of our administration, we got a free fall on the dollar a year or so later than it should have corrected. Being late and being excessive in amount that was needed, it went very far, very fast, and that, all by itself, was destabilizing, and one can only fear that we are building up again to something of that type.

So it could be—though needed as it is—very destabilizing itself.

Chairman GIBBONS. No one in your position wants to predict a crash of the dollar, but you certainly outlined for me a scenario for a crash.

Mr. Smith and Mr. Caldwell may get their wish. I hope Ford does not get caught as they did the year before last. I don't understand what I read in Ford's annual report about the money they lost, but, as I recall, they seemed to attribute a lot of their losses to failing to properly anticipate the exchange rates.

It is not clear from their financial statement, and I frankly did not pursue that discussion enough with Mr. Caldwell, but many of Mr. Ford's losses in 1981 appear to have been from exchange rate problems.

Mr. BERGSTEN. There is a particularly perverse angle there that you should know about.

Chairman GIBBONS. I would like to know about it.

Mr. BERGSTEN. An additional point to the ones I have been making as to why a very strong dollar can hurt the United States.

Under the accounting rules that are accepted in business practice today, a company with foreign operations, foreign profits, has to convert its foreign profits from deutsche marks or Mexican pesos, or whatever, back into the dollar at current exchange rates, so when the dollar is very strong, the deutsche mark earnings convert into fewer dollars, and, therefore, he shows either smaller going or bigger losses from his German operation, because the dollar is strong.

That means that his reported earnings, or P&L statement, is much worse perversely because of the strong dollar.

Chairman GIBBONS. Really? Ford did not have the big loss in 1981 that they reported?

Mr. BERGSTEN. As long as you believe that this strong dollar relationship is temporary and is bound to be corrected, then it is an accounting anomaly; exactly right.

Chairman GIBBONS. That seemed to be what Mr. Caldwell was saying. I did not pursue that with him.

Mr. BERGSTEN. Any major multinational firm faces this phenomenon.

The greater extent to which they rely on foreign earnings in their overall profit picture, the more they are hit by this.

Ford has recently reported losses in its North American operations and profits in the rest of the world. When the profits get converted back into dollars, they don't go very far to offset their North American losses, whereas in real terms they go much further to offset the losses.

The picture of any company with sizable foreign earnings this last year or so is badly distorted. Their position is much better than is indicated.

Any corporate executive will tell you that, because, in every quarterly publication of their earnings statement, they always put in a line, *x*-hundred million dollars reduction in our reported earnings is due to currency translation. Look in the statements of companies with big foreign operations—IBM, or the chemical companies, or a whole range of U.S. firms—and there is a line in there in every recent quarter, hundreds of millions of dollars have been deducted because of currency translation, and usually that is much more than had to be deducted a year ago; so it reduces the absolute level and makes the trend look worse.

Chairman GIBBONS. As it gets reported in the press, it is usually translated as being real losses and, in effect, they are only accounting losses, is that right?

Mr. BERGSTEN. Well, it is a little more complicated than that, and it gets to some fundamental accounting principles and also gets to the question of whether you think the current exchange rate alinement is out of whack, as I do, but if you answer those questions the way I would, then a lot of it is pure accounting.

In economic terms——

Chairman GIBBONS. Really not a loss of wealth—a loss of paper. Well, not even that—a loss of fictitious value?

Mr. BERGSTEN. Right, and in many cases they have not even converted their actual deutsche mark back into dollars, but ploughed them back into their German subsidiary.

For accounting purposes they have to show it in dollar equivalents, and that creates that very strange accounting picture.

Mr. BAILEY. Would the chairman yield? What you are not saying is that represents some relative strength in terms of what their domestic operation or investment would be. Is that correct?

What is the relationship between the accounting process and domestic investment or reinvestment?

Mr. BERGSTEN. Well, because of the effect on the P&L statement, it may weaken their ability to invest more capital here in the United States.

By writing down their earnings, it may give this distorted picture, and it may make it harder for them to borrow new capital. If they leave the money abroad in operational terms, reinvest it there, then it is kind of awash, but certainly this is true, they would be discouraged from repatriating the earnings.

Mr. BAILEY. Thank you.

Mr. BERGSTEN. They would be discouraged from repatriating the earnings; no question about that.

[The following was subsequently received:]

FORD MOTOR CO.,
Washington, D.C., October 19, 1982.

Hon. SAM GIBBONS,
Chairman, Subcommittee on Trade, Ways and Means Committee, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: In his appearance before the House Ways and Means Trade Subcommittee on September 30, Mr. Fred Bergsten engaged in a colloquy with you on the impact of foreign-currency translations on the earnings of multinational corporations, using Ford Motor Company earnings and losses as an example.

As Mr. Bergsten highlighted, currency-translation losses may well be confusing, particularly when they represent a substantial percentage of the parent company's losses or profits. We are concerned, however, that the statements made could be interpreted to mean that Ford's substantial losses in recent years were "paper losses" that had little effect on the Company's financial outlook. This is not the situation; more important, the key issue, in our view, is the competitiveness of American companies with the Japanese—a problem that is being magnified by changes in the yen/dollar relationship.

Accordingly, it would be appreciated if you insert the following comments in the printed record of the hearings at the point of the exchange:

"In spite of the accounting issue that Mr. Bergsten mentioned, changes in exchange rates between the U.S. dollar and foreign currencies can have a true economic impact on U.S. companies. In Ford's case, most of the profits earned overseas are being returned, to finance new products in the U.S. When these profits are returned, they are converted from foreign currencies to dollars at current exchange rates. Because the dollar is relatively strong, the earnings convert into fewer dollars than they would have a few years ago. This results in a real economic loss.

"Of even greater importance, changes in exchange rates have a major impact on our ability to compete against foreign imports. For example, since the Japanese automobile importers increased prices at 1982 model introduction, the U.S. dollar has strengthened by about 15% relative to the Japanese yen (233 yen per dollar to 270 yen per dollar), effectively increasing per-unit yen revenue for the Japanese by 15% with no change in U.S. prices or in yen costs. In total, exchange distortions alone provide the Japanese with a $1,500 per unit advantage—through no effort by the Japanese companies.

"The discussion of accounting standards for currency translations should not obscure the seriousness of the automobile industry's problems in the United States. Restoring a favorable economic climate in the U.S. and reestablishing fair and equitable terms of trade are prerequisites to restoring the financial health of American industry—including automobiles."

Thank you for permitting us to clarify this matter for the record.

Sincerely,

WAYNE H. SMITHEY,
Vice President, Government Relations.

Chairman GIBBONS. You get discouraged about our tax policy; that really discourages them from repatriating.

I wish we would have had you as the first witness.

Mr. Bailey.

Mr. BAILEY. I am very much impressed with your knowledge. I wish, however, in all fairness, Fred, that you could maybe follow up on some of the implications of obviously what is a very astute and knowledgeable mind, and one which I also admire.

Let's talk about implications and let me try to glean from your first comments, and let's talk about some policy requirements as opposed to needs on the part of the United States of America.

I want you to keep this in the back of your mind sort of hovering there, it does not have to be omnipresent, but something of which I hope you will be aware—and that is the Nation's free world requirements to lead and to maintain a certain amount of investor confidence in a thing called peace and world security.

Keeping that little responsibility hovering back there, you talked about investment conflicts. I will use the concept like investment war. That is overdoing it, but how about competing national industrial policies, if we did absolutely nothing in this country, maintain the present tax structure that we have, and did away with any interference with free trade, including pressures that produce so-called voluntary quotas, if we did not do anything about research and development relationships between any industries, let alone key or chosen industries in our Government, if we just did those things, and let the currency go, that issue, I really don't know who is right or wrong on that.

You said there are differences in opinion concerning some of the recommendations that you and others have made.

What would happen to our automobile industry or our steel industry in 10 or 15 years, in your opinion? Can they compete?

Mr. **Bergsten**. I may surprise you by saying that I really don't know.

Obviously, the implication of your question is that if we were to abdicate in the sense of Government policy to provide a supportive framework for key industries, that other countries would be able to out compete us.

I am a strong supporter of more R&D spending.

Mr. **Bailey**. I really wish the chairman were off that phone and were listening to you.

You were beginning to say something about—

Mr. **Bergsten**. Mr. Chairman, you are supposed to hear this now.

Chairman **Gibbons**. Good.

Mr. **Bergsten**. What I was saying was, the question was whether U.S. policy backing away from trying to support the competitiveness of U.S. industry would leave us in the lurch. I am a strong supporter of improved competitiveness on the part of American industry, R&D spending, tax policy that supported investment, not consumption, and most of the 1981 tax cut went to consumers, not to support investment savings.

Mr. **Bailey**. Thank you.

Mr. **Bergsten**. We clearly have a public responsibility to provide a policy framework within which U.S. productivity will expand.

The reason I said I don't know the outcome is because of the following puzzling fact. There is lots of talk about the decline in U.S. productivity growth and decline. There has been, but, for the last 10 years, productivity growth in every industrial country in the world has declined rapidly, and in the case of many of them it has declined more rapidly than here.

Japanese productivity growth, while still faster, has declined much more than ours has.

It is much closer to ours now than it was 10 years ago.

It is unclear, really, what the outcome of all these measures would be, but, on the basis of what we know, we ought to make every effort in responsible, positive areas, and you certainly mentioned a couple of them in R&D spending, and I would add investment tax policies which support innovation and investment spending, but remember, that whatever your tax policies, whatever your R&D support, you are not going to get investment and productivity growth if your economy is dead in the water.

You have to have the prospect of expanding markets so there is somebody to sell to and all the tax incentives in the world are not going to boost American capital equipment expenditures from where it is today.

Mr. **Bailey**. I think that goes without saying, and it is obvious, but let's get back to the point I was raising, and you apparently agree with the premise that I had stated. That is that I guess at the root of it all, if you look at American policy, and you look at some policies abroad, particularly with respect to certain basic industries, you are going to find a great deal of difference in tax structures in some case, particularly in the past, what you may or may not want to call protectionism.

A lot has to do with how you define protectionism and how far you take it or trace the impact on governmental policies on what that word may or may not mean.

I had asked you earlier, and you said you have the material available to you, therefore, I would invite your studies of the H-o-u-d-a-i-l-l-e [spelling], the Houdaille study. It is a rather unique petition to the President for relief, and it is an interesting case study, and I hope everyone has a chance to read that.

You say you don't know what would happen if we just did absolutely nothing in terms of basic industries like automobiles or steel.

If the United States and Japan, the United States and Europe were one country, I would not be concerned about these policy differences. I am not saying anyone is right or wrong in terms of what their domestic policies are, but I think it is pretty clear we have got to be honest with ourselves.

We can see the impact of different policies on things like world oversupply. We have a steel oversupply problem. We really do. We have an excess world capacity, and partially that has resulted from government policies on our part and other nations' parts. Something needs to be done to accommodate those kinds of changes.

A lot of people don't know that much about steel. They think in terms of raw steel production. They don't realize the mix, the batches, the technology, the allies. There is very little—in fact, there isn't really such a thing as plain old steel that you produce anymore. You are really into heat with different carbon components, different alloy specifics, et cetera.

I don't think it is very well realized today, the important connection between a supply of a basic material like steel and an issue like national defense. I don't think there is much understood about the relationship between investment policies and the failure of our country, for example, to do things like exploiting manganese nodules on ocean floors.

If you are familiar with that area and that study, you know our performance as a country has been pathetic in trying to get those situations worked out, in my view at least. It doesn't make me right, but that is my view.

Failure to come up with a national industrial policy has very much affected the allocation of resources investment in this country, in particularly basic mineral development. A part of that has been environmental policy.

I realize these are social issues and whatnot, and I am not saying that they were easily solved, if indeed they could have been. I don't think that would have been fair to past administrations, past politicians, or past citizens or those still living in this country, but I think the results have got to be noted.

If we could develop a truly world approach, an interdependent, free world economy, now let's sweep away that nagging dependence that we just might have on some basic industries for certain reasons, what would you recommend?

Incidentally, I am proud to be part of Fraser & Co. It is an honor. I think the guy is an exceptional American leader.

What would you recommend, particularly the issue of borrowing on Japan's capital market? Apparently you have heard Mr. Tippett's remarks or read them, and he seemed to disagree with your point. I am not expertise enough to challenge. I don't know. I know that this bill is creating a discussion that is badly needed in the United States, very, very badly needed.

What would you recommend the world do if you could sit back a way, aside from the currency thing, to address the issue? You referred to investment competition, I think. We have all kinds of concepts coming up, Mr. Bergsten. We have reciprocity. You may want to comment on that. I happen to be somebody who believes that would be an error and counterproductive.

I have made recommendations in the past on things like R&D to make us competitive. I have made recommendations on things like investment tax credits. I am a big believer that the greatest problem the United States of America as a nation faces is improvement of existing plant and equipment, reinvestment in plant and equipment. That is my belief.

I also believe we are going to have to balance things until we have a more peaceful world. I don't want to do that. I would rather have a comparative advantage world. I think the Japanese could be persuaded in a true comparative advantage world to really play by different rules, but some people feel threatened by the Japanese approach.

I don't know if that is justified or not. They hurt people, I think, with some of the things. You are familiar with the Wall Street Journal article. You read it this morning. It is indicative of the problems.

What would you recommend, aside from the currency changes, unless that is the only thing we can do that we do in the industrial policy area? I wish you would comment, please, on Government involvement in the financing, particularly of very long-term financing of expensive capital projects.

I am talking about everything from nuclear power. We have seen it with transit systems. We have seen it with turbine systems, power generating and that kind of thing. Would you comment on that?

Mr. **Bergsten**. I would start by saying you have raised a very big question.

Mr. **Bailey**. I realize that, but I think that is what has given rise. You really put your finger on it. You talked about the political pressures, and that is why this bill is here. Nobody has come in here saying this bill isn't in some ideal situation a great ideal. It is a reaction.

This bill is an American political reaction to a perceived abuse, and everybody comes in with these recommendations and the Assistant Secretary of State, who was here earlier, and he said he agreed with what I said, the comments I had made about American management and labor, and I didn't even ask him. He brought that point forward.

It means we have got to develop some Government policies, but you know this is a bandaid. Let's face it. The President is going to veto it or the Senate is not going to deal with it properly, whatever. But what are you going to do?

Mr. BERGSTEN. Well, when you raise the question of industrial policy, I think you do probably raise the most fundamental question underlying the next couple of decades of international economic relationships because so far what has been done in constructing an international——

Mr. BAILEY. Thank you for that compliment. I needed that. I have been going through 2 weeks trying to divert the discussion in that direction. I am grateful to you.

Mr. BERGSTEN. I think you have got your finger on the right problem. I am not sure we would agree on the right answer.

Mr. BAILEY. I realize that.

Mr. BERGSTEN. What I was going to say is that in constructing the international system since the Second World War, rules of the game, and more or less cooperative arrangements in institutions, have put in place in a number of areas; the monetary area through the International Monetary Fund, the trade system through the GATT, development assistance through the World Bank, and other institutions such as commodity agreements.

There is a whole panoply of international cooperative arrangements to manage a large part of the economic activity that goes on in the world in which nations bump into each other inevitably.

What has not yet really been addressed is the question you are raising of industrial policy and particularly investment. It has been addressed ad hoc when a specific issue comes up like the oversupply of steel. Then what happens is that the industry tries to get the Governments to essentially cartelize the world industry for it through voluntary restraint agreements or whatever.

Mr. BAILEY. The law sets up the forces to do that, though. The Government wrote that law to force them to do that.

Mr. BERGSTEN. Yes, it goes back and forth.

Mr. BAILEY. I am saying the Government is specifically involved in that process as a matter of law.

Mr. BERGSTEN. Oh, yes, absolutely, and I happen to think those policies are a mistake, but the point here is——

Mr. BAILEY [continuing]. That it should be improved?

Mr. BERGSTEN. Right. The point here is that the only efforts really to construct anything like what you might call industrial policy on an international basis, but ad hoc in response to pressures of exactly the type you are dealing with here—steel industry, textile and apparel industry, whatever it may be—that has been ad hoc and not very well thought through, always in reaction and response to a crisis at the moment and not done thoroughly.

So, I have felt for some years that the next big area where one has to move ahead in trying to work together internationally is in the investment and related area.

Mr. BAILEY. I agree. I am very pleased to hear you say that.

Mr. **Bergsten**. You used the word, too. I wrote an article in 1974 called "Coming Investment Wars?" It was a little premature, but——

Mr. **Bailey**. No, it wasn't. Somebody should have listened to you then. These roots go back too far.

Mr. **Bergsten**. Certainly by now we are seeing that kind of development evolve. Now, as I said way back in today's testimony, confronting increased Government intervention around the world the United States always has two choices, which boil down to fight them or join them. Fight them in this case means trying to get them off that wicket.

Mr. **Bailey**. Right.

Mr. **Bergsten**. And play by the more market-oriented approach.

Mr. **Bailey**. That is how I view this legislation in that context.

Mr. **Bergsten**. Join them, well, it is sort of in between this one. Join them means you emulate what the other guys are doing and here you are kind of part way in between, you would be joining the local content requirement in a number of other countries, and I fear pushing others in that same direction.

I guess I would put this one more in the join them category than I would the fight them.

Mr. **Bailey**. In isolation itself?

Mr. **Bergsten**. Right, but it is a tough choice because the pragmatic fact of the real world is other countries are going down this road.

Mr. **Bailey**. Yes.

Mr. **Bergsten**. And can we really, whatever our preference is, avoid fighting fire with fire?

Mr. **Bailey**. Could I ask a question? You opened your booklet and it caught my eye immediately, and that was some of the things about racial slur.

I am not that kind of person. I have been so sensitive up here. I mean, I don't feel that way in my heart. I have been very sensitive up here about some of the things that I have had to say that have been critical of Japanese practices.

I did some research on the Japanese reaction to the Mitsui situation. I found that the Japanese press viewed it essentially as some type of personal attack on Japan. I was terribly sad.

I don't feel that way. I think it was maybe a conflict of values, a conflict of perceptions on how to do business, but it was taken to Japan as some sort of anti-Japanese kind of feeling.

If there was an anti-Japanese tone at all, it is because there is at its root a very basic anti-type of doing business that way. It is in violation of our laws. It is clearly known that it was. It was a fraudulent practice.

There are criminal indictments that are going to be coming down. The damages look like they are absurdly diminutive, but I can understand the pressure that the Government is under and all that kind of stuff.

Can we afford to do things the Japanese way? Can the world afford to do things the Japanese way? I don't want to ask an unfair question. I realize that is terribly simple, because there are things we can learn from the Japanese, but I think that our approach to antitrust might be a better model for world competition than would the trading company approach. I just think it might be.

I think that our banking policies and our credit policies may be a better way to go. We have a much larger, more sprawling economy anyway. We have had better experience with it. It is a little more open.

How do you solve the problem? Do we modify our policy or do they, because I really think that at the root of the political agitation side, the political agitation that has resulted in Europe and here, has basically been a reaction to what people feel are unfair ways of doing business and approaching markets, entering markets, controlling markets, and destroying other people's competition in a market.

Mr. **Bergsten**. Let me tell you the way I see this evolving over time. Up until quite recently the United States has operated on a fundamentally different premise from that of all the other major countries in the following sense. The U.S. premise has been we do abroad what we do at home, whether it is antitrust or Glass-Steagall on the banking side or corrupt practices or whatever. We do abroad what we do at home. Our principles at home are good. We do them abroad. We want others to do them.

Mr. **Bailey**. We are a little more consistent.

Mr. **Bergsten**. Other countries have operated on a somewhat opposite premise. You do in Rome what the Romans do. You do abroad what is necessary to get the business.

Mr. **Bailey**. Right.

Mr. **Bergsten**. That is a little bit of a caricature on both sides, but it is fundamentally right. Over the last 5 to 10 years only, as the United States has become so much more interdependent with the world economy, the old U.S. premise is breaking down, and we can see in area after area export trading companies, changes in tax law, Export-Import Bank giving preferential import interest rates to exports relative to domestic.

Mr. **Bailey**. You think that is good?

Mr. **Bergsten**. Yes.

Mr. **Bailey**. You do?

Mr. **Bergsten**. When I was in charge of that for 4 years we increased the level of Ex-Im lending sevenfold, and I believe——

Mr. **Bailey**. Oh, no, I didn't mean that. I agree with you on that point very, very strongly, but that trend you think is positive, the way things are going?

Mr. **Bergsten**. Yes. What I was going to say was in a number of areas now, the United States is being forced by events to go in the direction of the other peoples' premises; namely, you do abroad what the other people do, what is necessary to get the business.

Mr. **Bailey**. How would you do that selling cigarettes in Japan? How are you going to break in? Bribe somebody?

Mr. **Bergsten**. No, I think in a case like that, if in fact you really have the goods, that you take them to the GATT and very rapidly respond in kind.

Mr. **Bailey**. Come on.

Mr. **Bergsten**. And very rapidly respond in kind.

Mr. **Bailey**. You are a very bright person.

Mr. **Bergsten**. That is what you should do.

Mr. **Bailey**. Yes, sir, I know, and that will be done. That will probably be done, but you know if you read this and you do a study of what you are up against, first of all, when you try to collect evidence, for example, on doing business, you run the risk of somebody coming in trying to enter a market, of gathering evidence, gathering witnesses, getting information presented, access to information.

You know all of those difficulties because of differences in legal systems.

Second, you are talking about in some cases when you are dealing with a relationship between a foreign practice and a foreign company, and their government, going in effect in a very, very sensitive national area, and Uncle Sam then steps in, you know this full well, and you get into policy and jawboning areas that put great pressures on American companies who are used to an adversary relationship essentially with government in many ways, and used to a very, very open media and public reaction and very, very open and assertive legal way of doing business. You go in there and fight for your rights in court, and there are systems conflicts there, in attitudes, in culture, in practice. You can complain to GATT on a GATT basis until you are blue in the face.

Mr. **Bergsten**. No, no. I said take it to the GATT and move expeditiously in response.

Mr. **Bailey**. What else would you do then? We know you can go to GATT. We know those things don't seem to be—I don't know—they don't seem to have influenced the British.

Mr. **Bergsten**. Let me declare what the remedy would be.

Mr. **Bailey**. Yes.

Mr. **Bergsten**. If you have a clear case where the other country is illegally keeping your goods out of their market, you retaliate in kind. You pick some product where they are vulnerable and you hit them.

Mr. **Bailey**. Can you do that today in America?

Mr. **Bergsten**. Sure.

Mr. **Bailey**. How? When was it done last?

Mr. **Bergsten**. You say could it be done or has it been done?

Mr. **Bailey**. When did we do it last?

Mr. **Bergsten**. It has been done on some small products, not on big ones.

Mr. **Bailey**. Could you give me examples?

Mr. **Bergsten**. Yes. There was a leather case in 1977 or 1978 where we went to the GATT and gave them the list we were going to retaliate on, and they modified their practices.

Mr. **Bailey**. I wish it would work. Until the industry, really, and the unions fought like the dickens in the steel area, for example, you couldn't even get the European governments to admit that they had a protective policy or even an oversupply situation. Finally they came in.

Do you know what they finally did under huge pressure? You know this of course. They came forward with a plan. This highlights the difference in our systems. They came forward with a planned reduction in steel capacity. Now, that tells you something, Fred, because in the United States of America our reaction to oversupply would have been let the market, let competition modify or seek a level where certain factors are simply driven out of business and cease to exist, are absorbed or whatever. That is roughly speaking the difference, but it highlights the failure of the systems to accommodate.

Could I tell you what I think we ought to try to do if we possibly could?

I think that we ought to use as much of our political and moral and rhetorical muscle, et cetera, and our economic muscle, to provide the administration with the tools to attempt to bring together major industrial nations to forge a consistent set of principles and policies dealing with a multitude of issues that affect our economic well-being.

They have got to deal in the area that you touched on. They have got to deal with tax policies and mechanisms to deal with rapid adjustments so that they cannot be exploited in the currency areas, and they have got to deal with problems like protectionism, tariffs, and everything else.

We have got to do that or the free world is not going to continue to function because if everybody did what the Japanese did, you know, if we marshaled our resources, and if we said tomorrow we are going to pour hundreds of millions of dollars into a steel industry and undersell Japanese industry and Japanese cars to make economic war on Japan, and we are willing as a nation to sacrifice, maybe we could win. I don't know, but that is crazy, obviously, it is insane, it is absurd, but this specter, I call it the state capitalism that is arising, modern state capitalism almost makes Karl Marx sound right on a few of his nutty theories.

I am not talking about dialectical materialism or anything of the sort. I am talking about his conjecture on trade wars between modern capitalistic nations.

Mr. **Bergsten**. I would say two or three things. One is that I have felt for some time that the next big area where international priority and negotiation is going to have to be directed is to this investment area.

I mentioned before the risk of investment wars, the need to coordinate policies in that area, at least to avoid overt conflict. I have suggested creating what might be called a GATT for investment. It always scares people when you conjure up the notion of some——

Mr. **Bailey**. No, sir.

Mr. **Bergsten** [continuing]. Some institutional arrangement, but it is such a huge area.

Mr. **Bailey**. You are right.

Mr. **Bergsten**. And so important that it is going to need to be done.

Two other points just on things that you have said. You mentioned the security consideration. I think that obviously is central. I have felt for many years that under our existing laws, there should be a national security study of, for example, the steel industry.

Mr. **Bailey**. Could I interrupt you? I served on the Armed Services panel that dealt with the defense industrial base. The chairman was Dick Ichord. He was kind enough to let me work into the record sections on basic productivity of American basic industries and raw materials supply.

It is an outstanding contribution to the issue you just raised. There has been a study. I have gone through 200 and some copies of the pamphlet in my office. I don't have anymore, but if you could dig it up and get it, I will tell you——

Mr. **Bergsten**. I would like to see that. The reference I had was to the fact that under the existing trade law, as I am sure you know, there is a provision that an industry can come in and seek relief on the basis of a national security finding, and I have thought that the particular industries who appeal to that factor, which is a fair one to appeal to, have every right and should in fact undergo an examination of that type, to see what size and shape industry the U.S. needs from a security standpoint.

Mr. **Bailey**. I agree with you.

Mr. **Bergsten**. I think that is right.

Mr. **Bailey**. I agree with you.

Mr. **Bergsten**. One other point. You mentioned in your comments another trade bill that is now before the Congress, the "reciprocity" legislation.

Mr. **Bailey**. Yes.

Mr. **Bergsten**. It just so happens that my institute published just last week a study of that particular issue entitled "Reciprocity: A New Approach To World Trade Policy?", in which we did a thorough analysis I think of the historical antecedents of traditional policies, the very fundamental changes in policy that would be implied in legislation of this type, however watered down the specific language may be. Therefore, we felt a very severe problem would emerge from that.

If the chairman would be interested, I would also submit that for the record and be delighted to make it available to the committee.

Mr. **Bailey**. I agree profoundly and deeply with what you have just said. I am delighted that this issue has come up. Mr. Chairman, there is a booklet entitled "Reciprocity: A New Approach To World Trade Policy?" by William R. Cline, published under the auspices of the Institute for International Economics, and I would ask unanimous consent that it be included and made part of the record at this point.

Chairman **Gibbons**. All right, sir, we will do that.

Mr. **Bailey**. Thank you, Mr. Chairman.

[The information follows:]

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2

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"RECIPROCITY": A NEW APPROACH TO WORLD TRADE POLICY?

William R. Cline

POLICY ANALYSES IN INTERNATIONAL ECONOMICS 2

"RECIPROCITY": A NEW APPROACH TO WORLD TRADE POLICY?

William R. Cline

INSTITUTE FOR INTERNATIONAL ECONOMICS
WASHINGTON, DC
SEPTEMBER 1982

Dr. William R. Cline is a Senior Fellow at the Institute for International Economics. He was formerly a Senior Fellow at the Brookings Institution; Deputy Director for Development and Trade Research at the US Treasury Department; Ford Foundation Visiting Professor at the Instituto de Planejamento Econômico e Social Aplicado (IPEA) in Brazil; Assistant Professor at Princeton University; and is currently a Professorial Lecturer at Johns Hopkins University School for Advanced International Studies. Dr. Cline has published many books and articles on trade and development.

This study was originally prepared for a conference, "Trade Policy in the 1980s," organized by the Institute for International Economics in Washington, June 23-25, 1982, and funded by the Rockefeller Foundation. It will be published in William R. Cline, ed., Trade Policy in the 1980s, *(Washington: Institute for International Economics, 1983 forthcoming).*

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INSTITUTE FOR INTERNATIONAL ECONOMICS

11 Dupont Circle, NW, Washington, DC 20036
(202) 328-0583 Telex: 248329 CEIP

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Preface

The Institute for International Economics is a private nonprofit research institution for the study and discussion of international economic policy. Its purpose is to analyze important issues in that area, and to develop and communicate practical new approaches for dealing with them.

The Institute was created in November 1981 through a generous commitment of funds from the German Marshall Fund of the United States. Financial support has been received from other private foundations and corporations, including a grant from the Rockefeller Foundation in support of the Institute Conference at which this study was first presented. The Institute is completely nonpartisan.

The Board of Directors bears overall responsibility for the Institute and gives general guidance and approval to its research program—including identification of topics that are likely to become important to international economic policymakers over the medium run (generally, one to three years) and which thus should be addressed by the Institute. The Director of the Institute, working closely with the staff and outside Advisory Committee, is responsible for the development of particular projects. The Director makes the final decision to publish an individual study, taking into account the views of a number of expert outside readers on each manuscript.

The Institute hopes that its studies and other activities will contribute to building a stronger foundation for international economic policy around the world. Comments as to how it can best do so are invited from readers of these publications.

C. Fred Bergsten
Director

Introduction

More than thirty bills have been introduced in the Ninety-seventh Congress calling for US government action to achieve "reciprocity in foreign trade," or, as this term is used in these proposals, access to foreign markets comparable to that in the United States. US reciprocity objectives in the past meant seeking reciprocal *changes* in protection in trade negotiations; the new approach seeks reciprocity in the *level* of protection *bilaterally* and over a certain *range of goods*. The principal proposals envision US retaliation in the form of higher protection against any foreign country that does not grant comparable market access to US exports. Whether or not any of these bills pass, the surge of congressional interest in this approach marks what may be a watershed in US commercial policy and requires a reexamination of that policy. Reciprocity enforced by retaliation would violate the fundamental principle of unconditional most-favored-nation (MFN) treatment followed by the United States for the last sixty years, and would risk trade wars through counterretaliation.

Critics of the new reciprocity, especially those in the foreign official community, maintain that it is thinly disguised protectionism. Ironically, key sponsors of reciprocity legislation consider it a preferable alternative to protection, one that is designed to address trade pressures by increasing US export opportunities rather than extending the network of barriers to US imports. Indeed, groups normally most inclined to support proposals for import barriers have not been enthusiastic about this legislation; for example, the AFL-CIO contends that it "diverts attention from the real problem" of excessive imports.[1] Nonetheless, the risk is high that a protectionist outcome would result from a strategy of reciprocity based on the threat of retaliation.

The new reciprocity movement has appropriated the term to a narrow usage focusing on equivalent market treatment, in some cases even for limited ranges of goods. In the more traditional conception of the term, reciprocity has meant a broad balance between the reduction in trade barriers offered by the United States and the liberalization secured from other major trading partners in negotiations, or reciprocity "at the margin" on a basis of all products considered together. US trade policy has always been built around this broader concept of reciprocity, and its achievement has been not only a goal but also in good measure an accomplishment of the succession of postwar trade negotiations. The new reciprocity movement focuses instead on reciprocity of the resulting outcome, and tends to base judgments on sectoral grounds rather than recognize an overall balance. It also tends to seek bilateral reciprocity of trade outcome, focusing on countries that have a bilateral surplus with the United States while not taking into account US bilateral trade surpluses with other areas.

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[1] *Washington Post*, 7 May 1982.

The basic policy issue is how the reciprocity objective of US policy should be defined. In short, has the trading environment reached a point where the United States should begin an aggressive campaign to demand liberalization by other countries, either in the aggregate or in specific sectors, by brandishing threats of retaliation whenever the United States unilaterally decides that the current balance of opportunities is "unfair"? Would US interests, and world interests, be served by this approach?

Before turning to detailed analysis of the new reciprocity movement, some of its most important aspects warrant special mention.

First, there is a strong *sectoral* theme to the push for reciprocity. Many of the proposed bills have called for reciprocal or symmetric treatment in individual product sectors such as telecommunications or high technology. The omnibus bills also have a sectoral nature in that they refer implicitly only to those broad product sectors where the United States is "competitive,"[2] and it is difficult to see how equal market access would be judged without reference to some specified range of products. Nonetheless, these broader bills represent a second (and, by mid-1982, dominant) track of the reciprocity movement that is multisectoral, specifically acknowledges that reciprocity need not mean symmetry of market access in a narrow sector, and recognizes that retaliation need not be confined to the specific sector where the grievance is found.

Second, a major objective of the reciprocity movement is to open up foreign markets in *services and foreign investment*, two areas that have been largely outside the trading rules of the General Agreement on Tariffs and Trade (GATT).

Third, the new reciprocity is *unilateral* in nature. As such, it would usually involve the unilateral scrapping by the United States of trade commitments agreed previously in negotiations. This reneging on US obligations, without international authorization, would be likely to precipitate foreign *retaliation*.

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[2] In introducing his bill (S. 2094) Senator John Danforth (R-Mo.) stated its purpose as: "To achieve the same degree of access to foreign markets for competitive US exports, services and investment that we accord to other countries." *Congressional Record* 128 (11), p. 5.

Fourth, the new reciprocity would force the complying foreign country into a position of either defaulting on its own MFN obligations to third parties or else making a new unilateral concession available to all—thereby discarding a bargaining chip for future negotiations. It is unclear whether even the reciprocity advocates would want foreign countries to make special liberalizing exceptions that applied to the United States but no other country.

Fifth, the push for reciprocity may well reflect an attempt to deal with what could be a growing phenomenon of *"arbitrary comparative advantage."* In some manufacturing products, the traditional bases for trade specialization—such as differences in relative national availabilities of labor, capital, skilled labor, and technological sophistication—may no longer dominate (as industrial and some developing countries become more similar in these attributes), while other traditional determinants of trade (such as natural resource endowment) may not be germane. In such products, the pattern of trade specialization may be arbitrary, and factors such as noncompetitive firm behavior and government intervention may determine which country prevails. In such products, the need for a "level playing ground" is especially acute. These themes of the reciprocity movement are discussed in greater detail below (including Appendix B), after an examination of the premises, principles, and likely outcome of the new reciprocity approach to trade policy.

Unequal Market Access?

The premise underlying the proposed reciprocity legislation is that, after decades of US leadership in trade liberalization, "the result is an American market with comparatively few import barriers while foreign markets are protected by a variety of restrictions."[3] Hence, the United States has lost its bargaining chips, and legislation providing the sanction of retaliation would restore them.

The widespread perception that the US market is substantially more open than foreign markets has little empirical support, at least for manufactured products. Tariffs after the Tokyo Round are at approximately the same (low) levels in the United States, Europe, Canada, and Japan. In the late 1970s and early 1980s, the product sectors protected overtly by major nontariff barriers (NTBs, such as those on textiles and apparel, footwear, television sets, and Japanese automobiles; and the trigger price mechanism [TPM] or quotas in steel) covered 34 percent of the market for US manufactures, 10 percent for Canada, 20 percent for Germany, 32 percent for France, 34 percent for Italy, 22 percent for the United Kingdom, and 7 percent for Japan.[4]

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[3] Ibid, p. 1.

The extent of market coverage does not reveal the severity of protection on the products in question, of course. For example, the degree of protection on Japanese automobiles is undoubtedly higher in Italy (where fewer than 3,000 units annually are permitted), France (where the limit is 3 percent of the market) and the United Kingdom (11 percent of the market) than in the United States, where the limit of 1.68 million units represents approximately 20 percent of the market.[5] Similarly, European quotas on steel imports have been more restrictive than the trigger price mechanism used in the United States in 1978–81. Moreover, the "trade coverage" of overt nontariff barriers does not capture the influence of discriminatory government procurement or of disguised barriers such as administrative guidance, cultural factors, and noncompetitive practices—influences that may be especially important in Japan.

Nonetheless, it is a sobering fact that the available empirical evidence on nontariff barriers, much of it based on a comprehensive compendium by GATT, does show that the portion of the market covered by nontariff barriers in the United States is comparable to or wider than in other major industrial countries. At the very least, this evidence implies that, contrary to the usual premise behind reciprocity legislation, there can be no automatic presumption that the United States has a substantially more open market than those of its major trading partners.

If the conventional wisdom of greater market access in the United States is suspect for manufactures, it is closer to the mark in agriculture. Europe's Common Agricultural Policy (CAP) and Japan's quotas on meat, rice, citrus fruits, and other agricultural items are substantially more restrictive than the protection of US agriculture (limited mainly to meat, dairy products, and sugar).[6] However, the main thrust of the new reciprocity approach concerns perceived imbalances in access to markets for manufactured goods, not agricultural products.

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[4] Weighting by each sector's share in total apparent consumption in manufacturing. William R. Cline, "Exports of Manufactures from Developing Countries: Performance and Prospects for Market Access" (Washington: Brookings Institution, 1982; processed).

[5] Shailendra J. Anjaria, Zubair Iqbal, Lorenzo L. Perez, and Wanda S. Tseng, *Trade Policy Developments in Industrial Countries* (Washington: International Monetary Fund, July 1981), pp. 13–15, and Andrew Loewinger, "Automobile Trade," in Gary Clyde Hufbauer, ed., *U.S. International Economic Policy 1981: A Draft Report* (Washington: Georgetown University, 1982), pp. 4–11.

But the real basis for the current perception of unequal access stems not from a careful analysis of protection itself, but primarily from growing frustration over the US bilateral trade deficit with Japan, which reached $16 billion in 1981[7] and is expected to hit $20–22 billion in 1982. Broadly, the reciprocity movement has been prompted almost exclusively by the persistent and (periodically resurfacing) perception that Japan keeps its market closed through a variety of devices. Indeed, some observers view the proposed reciprocity bills as part of a ritualized process whereby the US executive branch uses the threat of congressional action to extract Japanese concessions, but averts such legislation once concessions are obtained.[8]

Because so much of the impetus for reciprocity legislation comes from the frustration over Japan's perceived protection, a brief review of the evidence is in order.[9] It is generally agreed that, although Japan used protection for infant-industry development in the early postwar period, by now Japan's tariffs and overt NTBs in industry are as low as, or lower than, those of the United States. Agricultural quotas remain a problem, but do not appear to be the chief focus of congressional frustration. The immediate cause of the conflict is Japan's large bilateral surplus with the United States: in the words of Senator Robert Dole (R-Kan.), "reciprocity should be assessed not by what agreements promise but by actual results—by changes in the balance of trade and investment between ourselves and our major economic partners."[10]

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[6] See for example William R. Cline, Noboru Kawanabe, T.O.M. Kronsjo, and Thomas Williams, *Trade Negotiations in the Tokyo Round: A Quantitative Assessment* (Washington: Brookings Institution, 1978), ch. 4–5.

[7] *Survey of Current Business*, 62(5), May 1982, pp. 5–17.

[8] See Emilio Collado III, "Reciprocity Legislation" in Gary Clyde Hufbauer, ed., *U.S. International Economic Policy 1981: A Draft Report* (Washington: Georgetown University, 1982), ch. 5. On the other hand, some experts believe that, in the past, Japan has liberalized only in response to pressure and that the actual passage of reciprocity legislation would facilitate future bargaining with Japan. I.M. Destler, "How Not to Negotiate: Some Thoughts on Our Current Trade Flap with Japan," in House Foreign Affairs Committee, 97th Congress, 2nd Sess. *Government Decision Making in Japan, Implications for the United States,* report of a workshop organized by the Subcommittee on Asian and Pacific Affairs of the Committee on Foreign Affairs, the Woodrow Wilson International Center for Scholars of the Smithsonian Institution, and the Congressional Research Service of the Library of Congress, March 16, 1982, (Washington: US Government Printing Office 1982).

[9] An in-depth examination of the case of Japan, and of the structural features of its economy leading to its trade profile, appear in Gary R. Saxonhouse, "The Micro- and Macroeconomics of Foreign Sales to Japan," *Trade Policy in the 1980s,* William R. Cline, ed. (Washington: Institute for International Economics, 1983 forthcoming).

Surely bilateral trade balances cannot be the criterion for trade equity. It must be recalled that the United States runs a large surplus with Europe, but US policymakers would be incensed if Europeans cited this fact as evidence that the US market is more closed than the European market.

A more relevant question is whether Japan has run a total current account surplus that is disproportionately large. A large chronic surplus could reflect high protection. In fact, however, from 1973 through 1981 Japan's current account balance was negative in five years and positive in four. In the period before exchange rate floating, Japan's average current account surplus was relatively high (1.52 percent of GNP in 1968–72, although Japan had deficits in the early 1960s), but from 1973 to 1981 Japan's current account surplus was actually lower on average relative to GNP than those in the United States and Germany (0.15 percent versus 0.16 and 0.46 percent, respectively).[11]

More sophisticated critics point not to bilateral trade balances but to Japan's low ratio of manufactured imports to GNP as evidence of protection. In 1979 Japan's imports of manufactures were only 2.3 percent of GNP, compared with 3.1 percent in the United States and 8.8 percent in Germany.[12] However, the increase in oil prices inevitably drove Japan to a trading structure involving large surpluses in manufactures to compensate—by pure accounting necessity—for large deficits in primary products. Relatively low manufactured imports as a share of GNP should come as no great surprise.

On the other hand, Japan's share of total imports (not just manufactures) in GNP lies fully within the international pattern. In the period 1973–81, Japan's imports of all goods and services averaged 13.4 percent of GNP, intermediate between 9.1 percent in the United States and 25.3 percent in Germany (as would be expected considering that these two economies are larger and smaller, respectively, than the Japanese economy). Moreover, the 40 percent rise in imports relative to GNP for 1973–81 over the period 1968–72 was also intermediate between those in the United States (65 percent) and Germany (28 percent).[13] Thus, whether the criterion is the current account position over time, the average surplus relative to GNP, or average imports relative to GNP, Japan's profile shows no marked signs of excessive protection.

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[10] Robert Dole, "Reciprocity in Trade," *New York Times*, 22 January 1982.

[11] Calcualted from OECD *Economic Outlook* 30 (Dec. 1982), p. 143 and IMF *International Financial Statistics* (Yearbook 1981 and April 1982). The comparison is not biased by rising oil prices: from 1972 to 1980 the rise in the share of oil in imports was approximately 21 percentage points for both Japan (from 16.5 percent to 37.4 percent) and the United States (from 4.0 percent to 25.1 percent), although for Germany the rise was only 10 percentage points. Ibid.

[12] Calculated from OECD, *Statistics of Foreign Trade*, Series A (June 1982), pp. 30-32; IMF *International Financial Statistics* (July 1982). Manufactures are defined here as Standard International Trade Classification (SITC) categories 5 through 9.

The few sophisticated econometric studies of Japanese imports have failed to document any systematic bias toward a protected economy. In one statistical model relating manufactured imports to variables such as factor availabilities (capital, labor, human capital), distance, and resources (oil, iron ore, land), Saxonhouse finds that Japan's import profile is well explained by the underlying economic variables and shows no tendency toward downward bias from protection (indeed, some other industrial countries show more bias).[14]

There is, to be sure, a considerable anecdotal (or "eyewitness") tradition insisting that Japanese protection is severe and takes many indirect forms, from abuse of technical standards (such as time-consuming inspection of individual automobiles, or required changes in electrical cords for appliances) to cultural factors (distaste for imports, an antiquated distribution system). However, a close examination of this tradition suggests that it is not a persuasive indictment of Japanese practices; for example, sample surveys of US and other importers in the Japanese market show much lower incidence of complaints than would be expected from the anecdotal stereotypes.[15] Moreover, there are anecdotes that point in the opposite direction. For example, Coca-Cola is the largest selling soft drink in Japan, Schick is number one in the razor market, and Nestlés holds 70 percent of the instant coffee market.[16]

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[13] Calculated from IMF *International Financial Statistics*, various issues.

[14] Gary R. Saxonhouse, "Evolving Comparative Advantage and Japan's Imports of Manufactures" (Ann Arbor: University of Michigan, 1982; processed).

[15] Gary R. Saxonhouse, "The Micro- and Macroeconomics of Foreign Sales to Japan," in Cline, ed., *Trade Policy in the 1980s*, 1983 forthcoming.

Note that a recent survey by the American Chamber of Commerce in Japan does not reveal pervasive trade barriers in the perception of the American business community in Japan (questions about the presence of such barriers typically show only a minority of affirmative replies). The report acknowledges in the preface that "Perceived failure of the American business community to come forward with specifics has led many within the Japanese community to question the reality of the nontariff barrier problem and to assert that the Japanese market is, in fact, essentially open." The survey does show that US banking, insurance, and transportation firms operate under special difficulties such as foreign exchange controls and restrictions applied more severely to foreign than domestic firms; also, government procurement is considered discriminatory by respondents from the transportation and technology industries but is generally not a major problem for enterprises in nine other industries. American Chamber of Commerce in Japan, "Report on 1981/82 Trade-Investment Barrier Membership Survey" (Tokyo, March 8, 1982), and "U.S.-Japan Trade and Investment," ACCJ Position Papers (prepared for presentation in Washington, May 18–22, 1982; processed).

Perhaps the most intriguing critique is that industrial organization in Japan leads to systematic restriction of imports. A recent study of the semiconductor industry maintains that even after the Japanese government had liberalized trade and investment in the sector in 1976, the oligopolistic structure of Japan's industry limited imports.[17] Over 60 percent of the consumption of semiconductors in Japan is by the six largest Japanese electronics and computer firms producing semiconductors (reflecting their vertical integration). Much of their production of semiconductors is traded among them in a pattern of specialization. The study acknowledges that the decline of the share of imports in consumption of semiconductors from 31 percent in 1975 to 22 percent in 1978 may be "straightforward import substitution," but judges that more likely it is the result of collaborative action among Japanese firms after their mastery of the relevant technology. Although this analysis fails to answer why one Japanese firm would sacrifice profits by purchasing from another rather than from cheaper foreign supply, it is conceivable that at least in some product sectors Japanese oligopoly structure restrains imports (although the argument has more appeal for intermediate products such as semiconductors than for final consumer goods).

In general, however, there is little systematic, empirical evidence that Japan protects its market substantially more than the United States does its own. A salient point to recognize is that the trade conflicts with Japan have risen sharply in intensity during three periods over the past decade, coinciding with periods when the yen was undervalued (1970–71, 1976–77, 1981–82).[18] Yet protection is a continuous process, so there should have been no discontinuity in trade conflict if the true problem were underlying Japanese protection. All the evidence points to the exchange rate, not continuous protection, as the main source of difficulty. Today's trade problems with Japan seem to be driven mainly by an overvalued dollar and undervalued yen (resulting broadly from a tight-money, loose-fiscal-policy mix in the United States and the opposite mix in Japan).

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[16] *Wall Street Journal*, 28 June 1982.

[17] Michael Borrus, James Millstein, and John Zysman, *International Competition in Advanced Industrial Sectors: Trade and Development in the Semiconductor Industry*, study prepared for the use of the Joint Economic Committee, 97th Congress of the United States, 2nd Sess. (Washington: US Government Printing Office, 1982).

[18] This point is developed at length in C. Fred Bergsten and John Williamson, "Exchange Rates and Trade Policy" in Cline, ed., *Trade Policy in the 1980s*, 1983 forthcoming.

Although perceived protection by Japan is the motivating force behind most of the reciprocity bills, practices in other countries would surely be challenged on the basis of similar impressions of excessive protection. Canada's Foreign Investment Review Agency (FIRA) would be a natural target, and in this case the premise of lower "market access" abroad than in the United States appears warranted (although Canadians maintain that FIRA's controls on investment are transparent while similar controls are exercised by many countries through opaque administrative means).

Brazil and Mexico are countries that probably would be high on the list of targets for application of reciprocity pressure. Both have high protection and both actively affect the pattern of international trade through local content and export requirements in their agreements with multinational corporations.

The cases of Mexico, Brazil, and other developing countries are complicated, however. Their "reciprocity" tends to be automatic at the aggregate level, because their need for foreign exchange is so great that they tend to spend whatever amounts of it they can earn. They are not accumulating large idle reserves; indeed, they have rapidly built up sizable foreign debts. Their tariff and quota protection and investment requirements distort the composition of imports, but the level of their imports is essentially determined by their export earnings (and capital inflows). To force compositional changes in their industrial structure would benefit some US exporters but hurt others because, if Brazil (for example) imported more automobiles, it would have less foreign exchange left to import wide-bodied aircraft.

Moreover, Brazil, Mexico, and some other newly industrialized countries (NICs) can legitimately point to the argument of infant industries to justify some of their protection, considering that their domestic markets are large enough for potential economies of scale and that they have an increasingly sophisticated base of skilled labor. Over the longer run, better rules of the game will have to be worked out for trade with the newly industrialized countries. However, now is hardly the time to impose additional pressure on exports from Mexico and Brazil, considering their high external debt (much of it held by American banks) and their already severe balance of payments problems.

When the burden of proof is placed on the contention that the major industrial trading partners of the United States are vastly more protectionist than the United States itself, the proof is found wanting; and protection by the NICs, especially those in severe balance of payments difficulty, raises an essentially different set of issues. Thus, the fundamental premise of reciprocity legislation—that comparable market access in foreign countries does not now exist—is weak.

Discrimination vs Unconditional MFN

Even if that evidence is weak, some legislators feel it is time for US trade policy to "get tough." However, a move to a policy of attempting to force foreign liberalization through the threat of retaliation would almost inevitably violate the principle of unconditional most-favored-nation treatment that has been the foundation of trade negotiations for decades and is stated in Article I of the GATT:

> . . . any advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.[19]

If the United States (or any other country adopting reciprocity legislation) applied retaliatory action against another country because of "unequal access" to that country's market, treatment would no longer be uniform across suppliers, and unconditional MFN would be violated. This violation would occur despite protestations of some authors of reciprocity bills that their approach is consistent with the GATT (and, in the case of a key proposal, the original language stated that, somehow, action would "take account of the obligations of the United States under any trade agreement.")[20]

In historical terms such a sharp break from unconditional MFN would represent a watershed change in US policy, and a reversion to the conditional MFN practiced by the United States when it was a developing nation and a newcomer to world trade. Unconditional MFN was the norm in European trade as early as the fifteenth and sixteenth centuries (initially, for countries covered by treaties, and later, for all supplier countries); it emerged as each country sought in bilateral negotiations to ensure that it would not be granted lesser opportunities than other countries. As a new nation finding difficulty breaking into foreign markets, the United States adopted conditional MFN in its first treaty (with France) in 1786, and pursued a policy of setting high tariffs for negotiating purposes, making extension of MFN conditional on the granting of reciprocal concessions.[21] Europe turned toward the US pattern in the early nineteenth century but, influenced by liberalism, returned to unconditional MFN by the late nineteenth century.

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[19] General Agreement on Tariffs and Trade (1947, as amended), in J.H. Jackson, *Legal Problems of International Economic Relations, Documents Supplement* (St. Paul, Minn.: West Publishing Co., 1977), p. 4.

[20] The Danforth Bill, S. 2094, as originally submitted.

[21] Under conditional MFN, if country A grants a concession to country B in exchange for a given concession, A extends the concession to another country, C, only if C grants a corresponding concession. Under unconditional MFN, C obtains the concession without granting one of its own.

After World War I, with US manufactures much in demand in Europe, the United States adopted a policy of unconditional MFN (under authority in the Tariff Act of 1922—echoing one of Woodrow Wilson's 14 points—and by provisions in the Tariff Agreements of 1934). Thus, the dominant nation in world trade—England in the nineteenth century, the United States after World War I—has tended to support unconditional MFN, not surprisingly given the dominant country's favorable position for taking advantage of the general liberalization of trade markets. However, it was not merely commercial dominance that led to US support for unconditional MFN. In an important study written by the eminent trade economists F.W. Taussig and Jacob Viner, among others, the US Tariff Commission noted in 1919 that the past US practice of conditional MFN had caused "frequent controversies" as signatories of existing agreements claimed the benefits of new agreements concluded with third parties.[22]

The United States later insisted on unconditional MFN in the foundation of the GATT, and in a multilateral context the principle came to mean in broad terms that discrimination would be avoided. The essential logic was that "in the long run all countries will suffer from the inevitable distortion of trade patterns which will arise out of discrimination, even though they may be temporary beneficiaries."[23]

While adhering in principle to unconditional MFN, the postwar trade negotiations have generally managed to follow a reciprocity principle. Tariff concessions on an MFN basis have been worked out among principal suppliers with an eye to ensuring broad reciprocity. Some argue that in economic terms MFN has in practice been conditional because the products submitted for tariff liberalization have systematically been selected such that they came primarily from countries that offered tariff concessions in return, and tariff cuts might have been more limited had this not been the case.[24]

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[22] "The evidences show that the conclusion of reciprocity treaties is likely to lead to claims from States outside the agreement which, if granted, will defeat the purposes of the treaties, and which, if not granted, occasion the preferring of a charge of disloyalty to treaty obligations. The practice of making reciprocity treaties requires the conditional construction of the most-favored-nation clause. But the use by the United States of the conditional interpretation of the most-favored-nation clause has for half a century occasioned, and, if it is persisted in, will continue to occasion frequent controversies between the United States and European Countries." United States Tariff Commission, *Reciprocity and Commercial Treaties*, (Washington: US Government Printing Office, 1919), p. 42.

[23] Quoted from John W. Evans in J.H. Jackson, *Legal Problems of International Economic Relations: Cases, Materials and Text*, 1977, p. 517. The discussion here also draws on Committee on Finance, US Senate, 93rd Congress, 2nd Sess., Committee Print, *Executive Branch GATT Studies* No. 9 (Washington: US Government Printing Office, 1974).

In the opinion of the US executive branch in documentation preceding the Trade Act of 1974, "adherence to MFN, however qualified as time passed, deserves a good deal of the credit" for the enormous growth of world trade in the postwar period.[25] Although thorough studies on the effect of MFN (conditional or otherwise) do not exist, perhaps a sense of its importance may be gleaned from a comparison of US trade with those socialist countries that enjoy MFN status against trade with those that do not. In 1979, exports to the United States from non-MFN East Germany and USSR averaged 0.055 percent of their GNP, while for MFN-status Yugoslavia and Poland the figure was 0.56 percent, 10 times as high.[26] Thus, the level of protection facing non-MFN countries appears to be sufficiently high to reduce their market access considerably relative to MFN suppliers.

Deviation from unconditional MFN has long been permitted by special exceptions in the GATT for customs unions and free trade areas, in the belief that these tended to liberalize trade, and for government procurement. The US-Canadian automobile agreement is an exception authorized by GATT waiver.

In recent years, the erosion of unconditional MFN has grown. The Generalized System of Preferences (GSP) was a major departure from MFN. So is the proposed new US Caribbean Basin Initiative. The NTB codes of the Tokyo Round, especially those on subsidies and government procurement, were conditional upon signatory status (although there is serious dispute as to whether these codes will in the end stand up against challenge that they violate the right to unconditional MFN stated in Article I of the GATT).[27] Fearing the consequences for nonsignatory developing countries, the United Nations Conference on Trade and Development (UNCTAD) has warned against the trend toward conditional MFN (although it was the leading supporter of the GSP).[28] More drastic departures from unconditional MFN have occurred in the Multi-Fibre Arrangement (MFA) and in the voluntary export restraints that have emerged outside the context of GATT.

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[24] J. Michael Finger, "Trade Liberalization: A Public Choice Perspective," in Ryan C. Amacher, Gottfried Haberler, and Thomas D. Willett, eds., *Challenges to a Liberal International Economic* Order (Washington: American Enterprise Institute, 1979).

[25] *Executive Branch GATT Studies*, (Washington: US Government Printing Office, 1974) p. 4.

[26] Calculated from *Direction of Trade Statistics* (Yearbook 1981), pp. 380–82, and 1980 *World Bank Atlas: Population, Per Capita Produced, and Growth Rates*, p. 16.

[27] For an argument that the Codes are not in violation of GATT because the NTBs in question concern legitimate countermeasures that are inherently discriminatory among countries, see Gary Clyde Hufbauer, Joanna Shelton Erb and H.R. Starr, "The GATT Codes and the Unconditional Most-Favored-Nation Principle," *Law and Policy in International Business* 12 (1) 1980, pp. 59–93. Nevertheless, the United States recently backed down in a countervailing duty case in the face of India's contention that the US interpretation of the code violated GATT Article I.

Despite these instances of erosion of the principle, unconditional MFN still governs the bulk of trade today. For the United States, the exceptions of Canadian automobiles, textiles and apparel, the GSP, and Eastern bloc trade account for only 10 percent of total imports.[29] For the European Community the fraction is considerably higher, although less so if EC members are treated as a single bloc and only their trade with outsiders is considered—leaving their free trade arrangements with the European Free Trade Association (EFTA), textile-apparel arrangements, GSP, Lomé Convention preferences (for African, Caribbean, and Pacific developing economies), and Eastern bloc trade as their main exceptions to unconditional MFN. For its part, Japan has almost complete adherence to unconditional MFN, although it does have GSP. Whatever the effect of departures from unconditional MFN on actual trade values, they have not become dominant for trade policies. The NTB Codes of the Tokyo Round are the most important major recent policy development leading away from unconditional MFN. Yet it is ambiguous whether even these agreements depart from the principle. To be sure, an important element in achieving their negotiation was the perception, both by Europe and by the United States, that only signatories—countries undertaking the disciplines of the Codes—would receive their benefits. However, in November 1979 the Contracting Parties to GATT specifically reaffirmed that the Codes did not affect "existing rights" under GATT, including MFN rights under Article I. Some legal experts maintain that the November 1979 agreement and Article I of the GATT will require that members of the various MTN Agreements extend the same benefits to nonsignatories that they offer to each other under these codes.[30] Indeed, in 1981 the United States backed down in a confrontation with India over this issue in the case of the subsidy code.[31]

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[28] United Nations Conference on Trade and Development, "Multilateral Trade Negotiations, Conference decision 132(V)," TD/3(xxiv)/SC1/Misc.1, Statement of the Director of the Manufactures Division, 3rd meeting of the Sessional Committee I, Geneva, March 9, 1982.

[29] In 1980 total US imports were $253 billion. Non-MFN imports were: $7.6 billion, Canadian automobiles; $9.5 million, textiles and apparel; $7.3 billion, GSP; and $780 million, non-MFN countries of the socialist bloc. IMF, *Direction of Trade Statistics* (Yearbook, 1981); OECD, *Statistics of Foreign Trade, Series C* (1980); and Office of the US Trade Representative. Note that for textiles and apparel and Eastern bloc trade, a low share of trade may mean confirmation of a trade-distorting effect instead of evidence that departure from MFN is minor. On the other hand, there is a trade-increasing influence from the other departures from MFN: Canadian automobiles and GSP.

[30] John H. Jackson, "GATT Machinery and the Tokyo Round Agreements," in Cline, ed., *Trade Policy in the 1980s*, 1983 forthcoming.

There is a more fundamental distinction between the NTB codes and the new brand of reciprocity proposals, however. Whether or not the NTB codes departed from unconditional MFN, they were *multilateral* and *trade-creating* in nature. They embraced most of the major trading nations and on balance surely will cause more trade creation than trade diversion or suppression. The new reciprocity movement, to the contrary, would be bilateral in nature; and, as will be analyzed below, the chances are high that application of the new reciprocity approach would more often result in trade suppression (with new protection by all parties) rather than trade creation.

In sum, by the adoption of reciprocity legislation based on the threat of retaliation the United States would enter new, unknown territory in departure from unconditional MFN by moving from a passive form—the withholding of concessions—to an active or aggressive form—the imposition of new trade barriers. Policymakers should be fully aware of the fundamental break with at least six decades of US trading practice that this step would involve. To be sure, the door to the reciprocity-retaliation approach is already open a crack as the result of section 301 of the Trade Act of 1974 as amended in 1979 (and its precursor, section 252 of the Trade Expansion Act of 1962), which authorize the President to retaliate against a foreign practice that "is unjustifiable, unreasonable, or discriminatory and burdens or restricts US commerce."[32] But 301 cases have been minor, and a broad mandate from reciprocity legislation to seek out and (if necessary) retaliate against foreign protection considered "unequal" to domestic is much broader and more aggressive than section 301's surgical provisions for "unfair" trade.[33]

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[31] The United States had initially rejected India's membership in the subsidies code on grounds that India's offered reduction in export subsidies was inadequate. When, on these grounds, the United States then refused to apply its new injury test to the Indian products, India argued that nonrecognition of its code membership and failure to apply the injury test would violate its MFN rights under Article I of the GATT. The United States then agreed to recognize Indian membership in the code on the basis of an Indian "best endeavors" agreements to limit export subsidies. Bureau of National Affairs, *Importers Weekly*, "U.S. Accepts India as a Country Under the Agreements for Subsidy Code, GATT Case Dropped," 97 ITIM 5, October 7, 1981.

[32] US PL 93-618, January 3, 1975, as amended by PL 96-39, July 26, 1979.

[33] There have been a total of 31 cases under section 301 since its enactment. Of these, 17 have been settled, and 14 are pending. The President has taken action on only one case, concerning Canadian broadcast advertising (for which "mirror treatment" legislation, requested by both Presidents Carter and Reagan, is pending). Leonard Weiss, "Reciprocity" (Washington: American Society for International Law, forthcoming 1982). Congressional discontent with slow action on section 301 cases has been a source of the recent surge in proposed reciprocity legislation, but a substantially more active use of this provision would run the policy risks set forth below.

Dynamics of Retaliation

If the first fundamental point to recognize about reciprocity through retaliation is that it is a radical change in US trade policy, the second is that it opens up the Pandora's box of counterretaliation or trade wars.

So far the departures from unconditional MFN have been passive: the withholding of new concessions from a subgroup of nonreciprocal trading nations. Customs unions, the Canadian-US auto pact and the Tokyo Round NTB codes are in this category. The GSP and Caribbean Basin Initiative are also passive (withholding the benefits from ineligible countries) although their motivation is one of development assistance rather than reciprocity. The new reciprocity-retaliation approach would be an aggressive departure from unconditional MFN: new trade barriers would be erected against countries with trade practices considered nonreciprocal.

The danger of aggressive reciprocity is that foreign countries may respond in kind. Imposition of a retaliatory trade barrier may provoke the foreign country to impose counterretaliatory barriers of its own. Even if the foreign country does nothing, there will be no benefit to home-country exports, and there will probably be welfare losses to the home country from imposition of the initial trade barriers. The costs of protection include higher prices for consumers, loss of efficiency as resources are shifted to inefficient sectors, loss of competitive stimulus to technological change, and induced macroeconomic costs from the inflationary impact of rising import prices.

Higher protection abroad as the result of counterretaliation is not merely an abstract possibility. Historical experience has shown it to be a painfully real phenomenon. The most extreme case of retaliatory escalation occurred in the Great Depression. In 1930, the US Congress passed the Hawley–Smoot Act, which raised tariffs to frequently prohibitive levels.[34] After its passage by the House and before its passage by the Senate, diplomatic communications from 24 nations filled a publication of 200 pages with expressions of concern and veiled threats of retaliation. To no avail, over a thousand American economists petitioned President Herbert C. Hoover to veto the bill.

After its enactment, retaliatory actions were widespread. For example, Spain imposed prohibitive tariffs on imports of automobiles and other products and entered a preferential agreement with France. In Switzerland, shocked by the prohibitive US tariff on watches, there were mass meetings calling for a boycott of all US products. Mussolini announced that Italy would buy no more from the United States than the United States purchased from Italy. Canada struck back at imports of 125 major products, imposing duty surcharges on items such as chemicals from the United States.[35] The round of retaliatory tariff escalation touched off by the Hawley–Smoot Act reduced world trade and played a significant role in increasing the severity of the world depression.

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[34] The average collected tariff on dutiable items from from 39 percent in 1923–30 to 50 percent in 1931–35. See William R. Cline, "Long-term Change in Foreign Trade Policy of the United States," in Joint Economic Committee, 96th US Congress, 2nd Sess., *Special Study on Economic Change*, vol. 9, *The International Economy: U.S. Role in a World Market* (Washington: US Government Printing Office 1980) p. 188.

Episodes of trade retaliation have been rare in the postwar period, in part because policymakers had learned the lessons of the 1930s. The best known instance of retaliation in this period was the "chicken war" of 1963, when the United States increased duties on cognac and light trucks in retaliation for the restriction of imports of frozen chicken into the European Community (EC). In 1973 there was a "cattle war" between the United States and Canada. In the face of low US prices and rising Canadian imports, Canada first protected cattle by prohibiting entry of cattle that had received a particular growth hormone; it then imposed quotas under Article XIX of GATT (safeguard against injury). The United States retaliated with quotas against Canadian cattle and meat.[36]

At the present time the atmosphere is perhaps more highly charged for a potential explosion of retaliatory measures than at any other time in the postwar period. World economic stagnation from 1980 through 1982 has been the worst since the 1930s.[37] Unemployment in Europe and the United States stands near 10 percent and is expected to continue at this level in 1983.[38] In mid-1982 the decision of the Reagan administration to block the use of US technology for the Soviet-European gas pipeline introduced a new sense of economic confrontation between the United States and Europe. And, at the same time, the announcement of high US countervailing duties against imports of European steel further heightened confrontation.

Some European spokesmen warned that the steel and Soviet pipeline issues could precipitate European retaliation.[39] An early move by the European Community following the preliminary determination on countervailing duties in steel was to claim the right to increase duties in compensation for the US Domestic International Sales Corporation (DISC), the program deferring taxes on exports.[40] The timing of this move gave it the appearance of retaliation against the US position on steel. The EC has also reportedly threatened to retaliate against US agricultural products if US action is taken against steel.[41]

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[35] Asher Isaacs, *International Trade: Tariff and Commercial Policies* (Chicago: Richard D. Irwin, 1948), pp. 230–37.

[36] John H. Jackson, *Legal Problems of International Economic Relations* (St. Paul, Minn.: West, 1977), p. 844.

[37] Even though the 1974–75 recession was sharper, the average growth rate in industrial countries for the three years 1974–76 was 1.7 percent, compared with an expected average of 1.1 percent for 1980–82. IMF, *World Economic Outlook* (1982), p. 143.

[38] OECD *Economic Outlook* (31), July 1982, p. 4.

In short, the recent trading climate has been primed for a potentially explosive round of trade retaliation and counterretaliation. In this environment a new approach of aggressive reciprocity by the United States could trigger counterretaliation at least as often as it would achieve foreign liberalization.

The conditions under which aggressive reciprocity will be beneficial, and the alternative conditions causing it to leave the home and foreign countries worse off than before, can be defined more precisely. The remainder of this section develops this analysis.

The judgment about retaliation to promote reciprocity should hinge on an evaluation of domestic and international economic ("welfare") effects. Essentially, the merits or disadvantages of the strategy are similar to those of the customs union: is the net effect likely to be trade creation or trade diversion? In the case of aggressive reciprocity, the corresponding comparison is between trade creation and trade suppression (simply reduction of imports, rather than diversion from one supplier to another). And the comparison is inherently probabilistic: policymakers must evaluate the *probability* that the threat will achieve the desired opening of trade (trade creation) versus the probability that it will go unanswered and import barriers will be erected to carry out the threat. In the latter case, policymakers must consider the additional possibility that the foreign country will impose counterretaliation.

For the home country, the net expected economic benefits of the strategy of aggressive reciprocity may be conceived of as follows. The net economic benefit from the strategy *equals:*

(a) the gains from foreign compliance with the demanded liberalization *times* the probability of foreign capitulation;

minus (b) the economic loss from increased domestic protection from threat-enforcement *times* the probability that the foreign country will not capitulate;

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[39] *Washington Post*, 1 July 1982, p. A24.

[40] *Financial Times*, 7 July 1982, p. 18.

[41] *Washington Post*, 10 August 1982, p. A12.

plus (c) that same probability *times* the economic benefit from increased export prices relative to import prices (the optimum tariff effect discussed below);

minus (d) the joint probability that the foreign country fails to capitulate *and* that it counterretaliates by imposing protection of its own, *times* the economic loss resulting from that counterretaliation (Figure 1).[42]

The basic economic effects for the home country are as follows. In the first case, where the desired liberalization is achieved, there is the economic benefit (or "welfare gain") from increased exports as the foreign market opens. Classical static analysis ignores these gains, but dynamic analyses of trade liberalization have focused increasingly on effects associated with investment, economies of scale, and technological change, and to a considerable degree these effects are related more to the export side than the import side of liberalization. A more traditional reason for welfare gain from expansion of the export market is that the expansion of foreign demand raises the country's export prices relative to its import prices, improving its terms of trade (the "optimum tariff" argument).[43]

The second case, where the foreign country refuses to liberalize its market but takes no further action, generates contradictory effects. On the one hand, there is the economic (welfare) cost from trade suppression. This traditional cost is essentially the additional cost that consumers must pay for more expensive domestic production (less the implicit transfer to domestic producers) and the economic loss associated with diverting domestic resources from more efficient uses to inefficient production of goods that could be bought more cheaply abroad. Technically, the cost of production is the traditional static welfare "triangle" of "dead weight loss" (essentially, loss of consumer surplus and government tariff revenue uncompensated by increased producer surplus).[44] In addition, increased protection causes dynamic economic welfare costs associated with loss of pressure for technological change and from macroeconomic recessionary adjustment to in-

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[42] See equation (1), in Figure 1.

[43] Thus, Wonnacott and Wonnacott have recently explained the appeal of customs unions over unilateral trade liberalization by the consideration of optimum tariff gains from achieving reciprocal liberalization by the partner. Paul Wonnacott and Ronald Wonnacott, "Is Unilateral Tariff Reduction Preferable to a Customs Union? The Curious Case of the Missing Foreign Tariffs," *American Economic Review* 71, no. 4, 1981, pp. 704–14.

[44] *Consumer surplus* is the excess of what the public would be willing to pay for a product (considering that some individuals would still buy at higher prices) over what it actually pays. *Producer surplus* is the excess of what firms receive over the minimum they would have to receive to cover costs.

Figure 1 Factors determining whether aggressive reciprocity is effective

Factor	*Influence*	
P_1	Probability of foreign capitulation	Higher probability→more effective
P_2	Probability of noncapitulation by foreign country	Higher probability→less effective
P_3	Probability of foreign counter-relation, given non-capitulation	Higher probability→less effective
W_X	Economic benefits of increased exports	Greater benefit→more effective
W_M	Economic cost of increased domestic protection	Greater cost→less effective
W_{OT}	Economic benefits of increasing export price relative to import price	Larger benefit→more effective
W_{CR}	Economic cost to home country of foreign counter-retaliation	Larger cost→less effective

Note: Thus: equation (1) $w^* = p_1W_X + p_2[W_m + W_{OT}] + p_2[p_3W_{CR}]$ where w^* is the net welfare gain from the strategy of aggressive reciprocity, W_X is the welfare gain from successful opening of the foreign market, Wm is the welfare effect (loss) of increased domestic protection ($W_m<0$), W_{OT} is the welfare gain from imposing an optimum tariff, and W_{CR} the welfare effect of foreign counterretaliation ($W_{CR}<0$). Note that $W_{OT} + W_{CR}$ equal the net effects of an optimum tariff under foreign retaliation, in addition to other welfare losses from reduced exports included in W_{CR}. Note also that the analysis of this section uses the term "optimum tariff" as a shorthand reference to terms of trade effects (considering that the two principal economic cases for protection are the "optimum-tariff" and "infant-industry" arguments). In practice, there is no reason that the particular increase in protection chosen for implementation of aggressive reciprocity would be precisely the level of the optimum tariff (if that level could be identified).

The term p_1 is the probability that the foreign country will reduce its protection under threat as desired, p_2 is the probability that it will do nothing and the home country will impose the threatened barrier, and p_3 is the probability that in the face of the new barrier the foreign country counterretaliates with its own new protection. Either case 1 or case 2 must occur ($p_1 + p_2 = 1$); p_3 is a conditional probability that, given the decision of the partner country not to liberalize (case 2, probability p_2), that country also decides to counterretaliate.

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creased inflation spurred by higher import prices. On the other hand, if the home country is large enough, imposing protection may generate benefits by depressing the home country's demand for the good and shifting the *terms of trade* (ratio of export to import price) in favor of the home country (*optimum tariff benefits*).[45]

It should be noted that even if an optimum tariff welfare benefit can be obtained (before considering the impact of foreign retaliation), this benefit may be more than offset by losses in efficiency of resource allocation if protection is imposed on an individual sector.[46] The traditional optimum tariff literature deals with a single import product, but once multiple products are considered, there will be efficiency losses from protecting some and not others (because resources will be drawn away from other sectors, where their social marginal product is higher, and devoted to the protected sector, where it would now be lower). Some advocates of aggressive reciprocity who see it as an opportunity for obtaining special interest protection could become much less enthusiastic if the strategy were imposed efficiently by a uniform tariff imposed on all goods instead of being concentrated in special sectors.

In the third case the foreign country not only refuses to liberalize but also imposes new protection of its own, causing economic costs to the home country. Essentially these costs amount to a reduction of previously existing economic gains from home-country exports (analogous to the desired new benefits from still further export expansion) in addition to partial, full, or overcompensation of the optimum tariff gains the home country might have achieved in the absence of counterretaliation.

For the strategy of aggressive reciprocity to be beneficial to the home country, the expected (probability weighted) benefits from the potential gains must exceed the expected costs of the potential losses.[47]

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[45] However, aggressive reciprocity would usually be applied against a single country. For standardized commodities, such as grains, it would be unlikely that reducing the demand for the exports of a single country would reduce the world price of that good. Supplies from other countries would be easily interchangeable. In this case, a terms of trade gain would be unlikely. However, trade in some manufactures (such as automobiles) tends to be based on "differentiated products," where a single country in a sense provides a unique product. For such products, imposing protection and reducing demand for the country's exports could be sufficient to lower the price and yield terms of trade benefits for the home country.

[46] Technically, the misallocation of resources is captured by the left-hand triangle of welfare loss (excess production opportunity cost) in the standard diagram of welfare cost from protection. See Cline *et al.*, p. 42. Note that the tradition of examining the optimum tariff in terms of a single, economy-wide product has led some erroneously to apply the argument to a single sector, such as automobiles, without considering the consequences of resource allocation inefficiency.

Essentially, advocates of aggressive reciprocity implicitly assume that

(a) the probability of foreign capitulation is high (in equation [1], P_1, Figure 1, *Note*),
(b) the gains from opening foreign markets are high (W_E),
(c) the gains from terms of trade improvement (optimum tariff protection) are high (W_{OT}),
(d) the home costs of protection are low (W_m),
(e) the probability of counterretaliation is low (P_3), and
(f) the home costs of counterretaliation are low (W_{CR}).

Once again the Japanese-based inspiration for aggressive reciprocity comes to light: advocates often suggest that Japan would find it difficult to counterretaliate because Japan imports relatively little in manufactures from the United States. This view is not firmly based, however. If all products are considered, Japan imports 77 percent as much from the United States as it exports to this country.[48] Japan could retaliate in many products. For example, despite its beef protection Japan imports 60 percent of US beef exports[49]; the Japanese government could easily reallocate its beef import quotas away from the United States to other suppliers. Other examples would include shifting from US jet aircraft to the European Airbus and from US to Brazilian soybeans.

Moreover, once legislation were in place, and a whole new trade strategy had developed, there is no guarantee that Japan would remain the only target. There would be pressure to apply aggressive reciprocity against Europe for the Common Agricultural Policy, for example. With a large trade deficit with the United States, Europe is in a good position to retaliate. Even developing countries are in a position to retaliate: 32 percent of US exports went to nonoil developing countries in 1980,[50] and it is fully conceivable that in response to new US trade barriers, erected under a policy of aggressive reciprocity, countries such as Mexico and Brazil would counterretaliate (for example, with tariff surcharges or quotas on US goods) and buy their imports from other industrial countries.

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[47] Thus: equation (2) $P_1W_E + P_2W_{OT} > P_2[|(W_m + P_3W_{CR})|]$. Note that if the country is risk averse, the ratio of expected gains to expected losses, left hand side of (2) relative to right hand side, will have to be larger for the strategy to be desirable.

[48] For 1980. IMF, *Direction of Trade Statistics* (Yearbook, 1981) p. 226.

[49] Speech by Saburo Okita, former Foreign Minister of Japan, Institute for International Economics, Washington, July 22, 1982.

[50] IMF, *Direction of Trade Statistics* (Yearbook 1981) p. 380.

The dynamics of retaliation are set forth systematically in Figure 2. Countries A and B make a sequence of moves in a "game." The figure summarizes the possible outcome of each move, showing the first three complete moves in the game. If the advocates of aggressive reciprocity are right, the game would end happily at stage Ia, where the foreign country eliminates the protection in question in response to the threat of A's protection. But the other outcomes show how aggressive reciprocity can escalate into more protection on both sides.

As an example of what can go wrong with the reciprocity approach, consider one of the possible sequences illustrated. Country A issues a threat to raise protection in a sector if the foreign country does not reduce its protection. Suppose the other country (B) makes no initial response (case Ib). Then home country A is compelled to follow through on its threat and impose the protection. Suppose that in the face of this action, country B then responds with a retaliatory increase in its own protection (case IIf). If the home country (A) takes no further action, both countries are left with a new, higher level of protection (case IIIm).

In the summary of all [illegible]nces of possible moves in Figure 2, after three rounds of play [illegible] nine ending positions (Ia, IId, IIe, IIg, IIh, IIj, IIIk, IIIm, IIIp) and [illegible]sitions leading to a further round. Of the nine ending positions, [illegible]e unambiguously liberalize trade (Ia, IId, IIg). The others incr[illegible]tion. Except in the case that country A's terms of trade [illegible]ariff) gains outweigh its protection costs (a possibility but not necessarily likely in cases IIe and IIh), or in the case that country A has special trade elasticities that enable it to gain from imposing an optimum tariff despite foreign retaliation (possible but unlikely in case IIIm),[51] or in the case of return to the status quo, country A's strategy of aggressive reciprocity backfires. In all end positions except liberalization or return to the status quo, country B is also worse off (unless its trade elasticities are peculiarly such that it gains from an optimum tariff despite retaliation). Thus, aggressive retaliation is a high risk strategy: it may achieve liberalization but may also result in higher protection and lower economic welfare for all.

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[51] The special case of optimum tariff gain despite retaliation, generally considered an intellectual curiosity rather than a realistic policy option, is developed in Harry G. Johnson, *International Trade and Economic Growth* (Cambridge, Mass.: Harvard University Press, 1967). Gain despite counterretaliation is usually unlikely unless the foreign country is small, in which case the initial offense would not be likely to be a major concern to the home country in the first place.

FIGURE 2 Dynamics of retaliation

Country **A** *action*	*Country* **B** *response*		
I. Initial threat	Liberalize a	No change b	Counterthreat c
II. Case **Ia**:	Game ends. Foreign market liberalized. Welfare improved for A, perhaps for B.		
Case **Ib**:	Liberalize	No Change	Impose counter-protection
Impose protection	d	e	f
Case **Ic**:	Liberalize	No change	Impose counter-protection
Impose protection	g	h	i
Remove threat	...	j	...
III. Cases **IId**, **IIg**:	Game ends. Foreign market liberalized. Country **A** removes the new protection. Welfare improvement.		
Cases **IIe**, **IIh**:	Game ends. Increased protection in **A**. Welfare loss for both unless optimum tariff for **A** dominates.		
Cases **IIf**, **IIi**:	Remove new barrier	Maintain new barrier	Impose further barrier
Remove new barrier	k	...	...
Maintain new barrier	...	m	...
Impose further barrier	n	p	q

If IIIk, return to *status quo ex ante.* Game ends.
If IIIm, stabilize, game ends. Higher protection on both sides, welfare lower for both.
If IIIn, may revert to *status quo ex ante* in fourth round.
If IIIp, stabilize with higher protection in **B**, much higher protection in **A**. Game ends.
If IIIq, much higher protection in both **A** and **B** with further escalation possible in round IV.

Note: undesignated cases (...) represent implausible responses.

An important structural feature of the risk of escalation comes from the fact that aggressive reciprocity is unilateral. It does not involve submission of a complaint to international consideration and the securing of international approval to carry out a retaliatory measure. This unilateral action seems much more likely to induce counterretaliation than would a multilaterally approved measure. Thus, in the "chicken war," the United States obtained GATT approval of compensatory retaliation. The EC did not escalate the retaliation further, but might have done so if the imprimatur of international legitimacy had not been given by GATT to the US measures.

In sum, perhaps the greatest risk of aggressive reciprocity is that it would spiral out of control in a series of retaliatory protective measures. Its unilateral nature increases this risk, as does the recent environment of trade confrontation (especially between the United States and Europe).

Sectoral Reciprocity

In addition to omnibus bills, the reciprocity proposals before the US Congress in early 1982 included bills limited to specific sectors: services, high technology, agriculture, and telecommunications, where a "mirror" bill would limit tax deductibility of broadcasting in view of a recent denial by Canada of tax deductions for border advertising on US stations.

The sectoral approach to reciprocity has some appeal and some weaknesses. Its appeal lies in its (implicit) recognition that in certain (broad) sectors national resource, factor, and technology endowments are sufficiently similar that comparative advantage may be relatively arbitrary and subject to manipulation (Appendix B). If in a given sector foreign countries act strategically while the United States acts competitively, US producers in that sector may be at a disadvantage.[52] Thus, the sectors of telecommunications, high technology, and services, where underlying conditions may make comparative advantage relatively arbitrary, are logical candidates for special action—although, again, aggressive reciprocity is a riskier and less desirable form of action than other policy alternatives (discussed below).

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[52] Although government intervention or other strategic behavior is no guarantee that the favored sector will prosper. The European aircraft industry could well have been better off if it had not undertaken the government-sponsored *Concorde*. Similarly, heavy-handed government intervention has failed to establish a successful computer industry in France. John Diebold, "The Information Technology Industries: A Case Study of High Technology Trade," in Cline, ed., *Trade Policy in the 1980s*.

Agricultural products, on the other hand, are not sensible "sectors" for reciprocity. By definition an agricultural product is dominated by Ricardian resource-based trade. In sectors where trade is one-way (as in agriculture), sectoral reciprocity makes no sense. This Ricardian, specialized, interindustry trade is such that, if the sector is a major exporter, there are only small imports, if any, to retaliate against. Thus it would be incongruous to impose reciprocity on oil, chromium, soybeans, wheat, or other narrowly defined sectors in the raw materials field: a country either exports or imports such goods (they are homogeneous and product differentiation generating two-way trade is minimal). Sectoral reciprocity makes sense only where there is two-way, intra-industry trade.[53]

Even at a broader level, however, the sectoral approach to (aggressive) reciprocity has serious limitations. Because different countries specialize in different sectors, trade can be broadly reciprocal even if the concessions of one country are in one sector and those of another country are in a different sector. A crucial element in the bargaining that has led to postwar trade liberalization has been the flexibility to arrange packages that involve reciprocal liberalization in the aggregate, with swapping of concessions in different sectors. To move toward a more rigid approach of sectoral reciprocity would limit the flexibility for future liberalization. Moreover, "aggressive" threats of new protection would be open to the legitimate charge that the demand was for a concession that had not been "paid for," and that in past negotiations the foreign country had already paid for liberalization in the home country in the sector in question with concessions of its own in other sectors.

The best strategy for dealing with the sectoral issues associated with arbitrary comparative advantage, while preserving the flexibility for intersectoral trade-offs necessary to broad trade liberalization, would be to develop special sector negotiations in GATT, as discussed below. It could achieve multilateral support instead of involving more risky unilateral action, and would give scope for recognition of extrasectoral concessions that country negotiators might offer (or believe had already been granted in the past).

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[53] Broadening the scope to agriculture as a whole does not help much. The United States does not import agricultural products from Japan, and the minor imports of agricultural goods (for example, dairy products) from Europe are hardly sufficient to pose a convincing threat that would deal with the problem of European subsidization in third country markets, let alone bring down the CAP.

Services and Investment

Two of the potentially most important areas for new sector negotiations are services and trade-related investment issues. These two areas have special significance for reciprocity legislation. They are both largely outside the GATT at the present time. As a result, it would be possible to adopt a strategy of "aggressive reciprocity" on services and investment without violating the unconditional MFN provision of the GATT. Also, the existing section 301 on unfair trade in the US Trade Act of 1974 does not explicitly include investment, although as amended in 1979 the act does include services.

The legal technicalities should not confuse the broader question, however: is it desirable for the United States to initiate a new regime of unilateral threat of retaliation in the name of opening foreign markets in services and in relation to investment requirements as they affect trade? All of the considerations of risk of retaliatory escalation discussed above would apply to these two areas. And while it would not violate past agreements (because the areas have been omitted from past commitments), a unilateral, aggressive reciprocity approach would be a sharp break from US policy as practiced for several decades.[54]

Alternative Strategies

Rather than breaking with its long tradition of unconditional MFN and risking a spiral of counterretaliatory protection from unilateral threats, the United States (and other countries) would do better to pursue some or all the following strategies for opening foreign markets.

(1) GATT Article XXIII. This article of the GATT provides that a country has the right to seek compensation for *nullification and impairment* of past trade concessions by other countries. Tariff cuts that turn out to be thwarted by NTBs (new or previously invisible) are ideal examples of nullification or impairment of previous concessions. For example, if in high technology goods it can be demonstrated that Japan or another country is acting so as to make previous tariff cuts meaningless, the United States (and other suppliers) can initiate an Article

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[54] However, a simple amendment of Section 301 of the US Trade Act of 1974 to include investment-related trade problems, if unaccompanied by new language tending to broaden the strategy of imposing retaliatory protection (especially on narrow grounds of lack of reciprocity), might be appropriate if one believes that section 301 is desirable in the first place.

XXIII proceeding. If the GATT rules in favor of the complaint and if the offending country makes no change, the complaining country is entitled to take compensatory actions against the country individually such as increasing tariffs on the same or other goods. This procedure permits multilateral authorization of such retaliation, minimizing the possibility that the offending country will maintain it has a basis for adopting counterretaliation.

In practice, Article XXIII has proved cumbersome, largely because other GATT members must approve the request for compensation. GATT has authorized suspension of concessions under the article only once.[55] Nevertheless, this provision of GATT represents a vehicle for dramatizing complaints about a particular trade practice, and if that practice is sufficiently objectionable to a large number of GATT members, authorization for compensation may be achieved. It would be worth an effort to revive Article XXIII, and cooperation by other members might be more forthcoming at a time when the alternative seems to be a drift toward unilateral action.[56]

(2) GATT Article XXVIII. This article of the GATT permits a country to rescind previous trade concessions, either by agreement with the principal suppliers (in which case the country is to offer compensatory liberalization in other areas), or unilaterally (in which case other GATT members are free to withdraw concessions of their own). If a concrete practice of a foreign country were objected to, the United States could raise duties (withdraw past concessions) on products of interest to the offending country, in the understanding that the country would have the right to make compensatory withdrawals of concessions. Such withdrawals (reimposition of higher tariffs) might not reduce US exports by much if the foreign country had been obstructing trade through administrative guidance or other means, thereby keeping its imports low despite past tariff cuts. This article does have its disadvantages: it spills over into the trade of other countries (as the withdrawal of concessions would be based on MFN), and it runs the risk of heightened protection on both sides. But it has the advantage of being within GATT and permitting unilateral action when multilateral support cannot be obtained for an Article XXIII action.

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[55] In 1952, when a complaint by the Netherlands against US restrictions on cheese imports was authorized. John H. Jackson, *Legal Problems of International Economic Relations*, (1977), p. 429.

[56] The EC has recently brought an Article XXIII action against Japan. However, the complaint is so sweeping, condemning "the structure and organisation of the Japanese economy," that it is poorly suited for meaningful GATT treatment. *Financial Times*, 13 July 1982.

(3) Negotiations on Services and Investment. Because the GATT focuses on merchandise trade, recourse to existing GATT rules is inadequate to deal with these areas. The best approach here would be to initiate negotiations for new international rules, and indeed the US administration is pursuing this approach. (Such negotiations would have to take cognizance of existing agreements such as those in the areas of civil aviation and shipping.) In the past the United States has supported international negotiations to deal with new trade problems as they arise rather than addressing them immediately with unilateral punitive action. There is no reason why the areas of services and investment should be excepted.

(4) NTB Codes. Some of the sectoral disputes should be manageable within the existing NTB codes. For example, the conflicts on openness of government purchasing of telecommunications equipment should in principle be subject to treatment within the government procurement code.

(5) Sectoral Negotiations. New negotiations could be pursued in the sectors of telecommunications, high technology, and any other sectors emerging as flash points in the push for an approach of aggressive reciprocity. This approach has already borne fruit in the Tokyo Round code on trade in aircraft. However, it is important in sectoral negotiations to avoid the emergence of new regimes restricting international trade. There is considerable risk that steel-sector negotiations, for example, would produce a new system of organized world quotas analogous to the Multi-Fibre Arrangement. There are better prospects for sector negotiations in the "sunrise" industries (for example, high technology) than in the "sunset" industries, because in the new sectors the problem is one of establishing rules of the game for future production and trade rather than seeking downward adjustment of existing production and employment in the face of excess capacity.

(6) Bilateral Negotiations. To the extent that trade conflicts prompting the surge of interest in aggressive reciprocity stem from disputes with individual countries (especially Japan), a more formalized process of bilateral trade negotiations could help.

All of these alternative policy strategies would have the advantage of avoiding unilateral action, of avoiding violation of the GATT commitment to unconditional MFN, and of minimizing the risk of an outbreak of counterretaliatory trade wars.

Despite these possible alternatives to aggressive reciprocity, there should be no illusion that it will be easy to achieve the desired results. The past limitations of Article XXIII, for example, have already been mentioned. And advocates of reciprocity bills contend that without such legislation the United States will have no leverage for the various potential negotiations listed here.

In the past the leverage for trade negotiations has come from the ability to offer liberalization of the home market in exchange for liberalization abroad. As discussed above, contrary to the view of many supporters of reciprocity legislation, the United States still has considerable protection that could be reduced in exchange for foreign liberalization. An end to voluntary export restraints on automobiles could be offered to the Japanese in exchange for a list of requested liberalizations. Cuts on tariffs on imported apparel could be offered to Europe in exchange for liberalization of agricultural products. Of course, such exchanges could be painful politically on both sides; the relatively painless offers of liberalization have been largely exhausted in past negotiations.

If it is politically infeasible to liberalize the remaining areas of US protection, the fact may have to be faced that indeed the leverage for further liberalization abroad is limited. In this case the appropriate conclusion to draw is not that the United States needs a new weapon in its negotiating arsenal in the form of aggressive threats of new protection. Such threats seem likely to lead to immediate costs from higher protection at home and a serious risk of escalating trade wars, as discussed above. Instead, the appropriate conclusion is likely to be that whatever liberalization is possible must be achieved within the multilateral regimes that have been developed over several rounds of postwar negotiations, including the new codes on nontariff barriers, while seeking to develop corresponding new regimes in such emerging areas as high technology, services, and investment.

Conclusions and Policy Implications

There has been a rash of bills calling for US unilateral imposition of new protection if foreign countries do not give equal market access, comparable to that in the United States. It would be a historic mistake in US policy to adopt such legislation. It is grounded in the weak premise that the US market is much more open than the markets of other major nations. Implementation of retaliatory protection would violate not only the US commitments under the GATT but also six decades of US adherence to the principle of unconditional most-favored-nation treatment. Such action, which may be called "aggressive reciprocity" (as opposed to "passive" reciprocity whereby new concessions are not granted in the absence of reciprocal liberalization), would run a serious risk of counterretaliation, with increased protection and reduced welfare on all sides.

Advocates of the legislation have failed to take sufficient account of not only the possibility and cost of counterretaliation but also the direct domestic cost of unilateral imposition of new protection. Pursuit of open markets through more active use of GATT Articles XXIII (nullification and impairment), and XXVIII (withdrawal of concessions), and new negotiations on services and investment at the sectoral and bilateral levels, would be far preferable to adopting aggressive reciprocity.

Appendices

A Selected Reciprocity Proposals

The leading general reciprocity bills are probably those proposed by Senator John C. Danforth (R-Mo.) and others (S. 2094) and by Senator John R. Heinz (R-Pa., S. 2071).[57] The Danforth bill as revised and reported favorably out of the Senate Finance Committee (on June 30, 1982) had the blessing of the administration, given certain moderating changes from its initial form. The original Danforth bill required the President to carry out annual studies that enumerate, and estimate the economic impact of, those practices by foreign countries that "deny to the United States commercial opportunities substantially equivalent to those offered by the United States." (Any analyst who has attempted to quantify NTBs knows how difficult a true assessment of this sort would be; it would probably require sample surveys in the offending country to estimate tariff-equivalents.) These practices include any in the fields of services and investment.

The initial draft of the bill required the President to "propose such actions as may be necessary to redress any imbalances," in other words, to issue a public threat to be implemented "if efforts to obtain their elimination fail." While the bill did not pose a deadline for implementing any threat, it clearly tended to tie the hands of the President, placing him in a humiliating position if he were to back down on a publicly stated threat. The bill also amended section 301 of the Trade Act of 1974, including in the definition of unfair trade the denial to the United States of commercial opportunities substantially equivalent to those offered by the United States, extending coverage to foreign investment, authorizing retaliation through government procurement and independent federal regulatory agencies, allowing Congress to initiate 301 actions, and requiring the President to announce retaliatory measures being considered. (Retaliation by restricting foreign investment is curious in that usually it is welcomed as providing a source of additional employment.)

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[57] This appendix draws upon Alfred Reifman, "Reciprocity in Foreign Trade" Issue Brief No. IB82043 (Washington, DC: Congressional Research Service, Library of Congress, 1982), and Emilio Collado III, "Reciprocity Legislation," in addition to the underlying bills.

Ironically, the original bill provided that action could be either nondiscriminatory or "solely against the products, investments, or services of the foreign country involved," yet it provided that the President "shall take into account the obligations of the United States under any trade agreement." These two provisions are contradictory in light of the unconditional MFN set forth in Article I of the GATT, unless the authors of the bill envisioned limitations of retaliation to services or investment (not covered by GATT) and not goods, or to government procurement (which, arguably, is also not subject to Article I because of the exception given in Article III:8a).

The revised Danforth bill as reported out of committee retained most of the basic features of the original version, including the annual study of foreign trade barriers and extension of Article 301 to cover investment. The major softening of the original bill was in the elimination of the requirement that the President announce publicly in advance the options he was considering to force a change in foreign trade practices (that is, public statement of a threat).

However, the revised bill still required the President to report annually on the steps actually being taken to obtain changes in foreign practices, meaning that the procedures would still tend to build up pressure for the President to take retaliatory measures. Although the revised bill removed the language "substantially equivalent" market access from the operational section, it inserted this same language in the statement of purposes. The operational definition of "unreasonable" practices in the revised bill referred to any act that "denies fair and equitable. . . market opportunities," and the implication remained that such fairness and equity would be judged on a basis of the substantially equivalent access cited in the statement of purpose. Moreover, the revised bill removed the passage requiring that retaliatory action take into account obligations under trade agreements.

Despite the common impression that the revised bill was substantially milder than the original version, the same fundamental objections raised in this study would apply to it. It would mark the adoption of a new basic trade strategy that would be unilateral and would seek to open markets by threatening retaliation. The revised bill did add an important new dimension in that it would establish authority for new negotiations on services, foreign investment, and high technology goods; but this authority is separable from the reciprocity thrust of the bill and could be enacted independently.

The Heinz and Danforth bills are similar in revising section 301 and including investment. The Heinz bill provides additional detail on retaliatory options, such as opposing loans to the country by the World Bank and the

International Monetary Fund, and provides for "mirror" legislation to impose restrictions similar to those by a foreign country. The Heinz bill emphasizes that nonreciprocal market access and nonnational treatment are grounds for US action whether or not they violate the GATT. More narrow sector-reciprocity bills have also been proposed, as noted above.

B Arbitrary Comparative Advantage

Much of the impetus for the new quest for reciprocity derives from the perception that in certain manufactured products (such as semiconductors) some countries are artificially achieving a comparative advantage that otherwise would lie with other countries. Analytically there does seem to be a fundamental problem that might be christened "arbitrary comparative advantage." Increasingly, trade in manufactures among industrial countries, even including the newly industrialized countries (NICs), appears to reflect an exchange of goods in which one nation could be just as likely as another, *ex ante*, to develop comparative advantage, and the actual outcome is in a meaningful sense arbitrary. For a range of manufactured goods, it may be argued that "comparative advantage is made, not given."

This type of trade differs from classical Ricardian trade, where comparative costs differ because (for example) one country has the climate for vineyards while another specializes in manufactures because of its abundance of skilled labor. Generally, in agricultural products and minerals the natural resource endowment prescribes an obvious national comparative advantage (although it can be thwarted by, for example, quotas to protect beet sugar from cane sugar). Similarly (though more ambiguously), Heckscher–Ohlin trade—based on different relative endowments of capital, labor, and skilled labor—involves a natural pattern of exchange whereby each country specializes in products that are intensive in the use of factors this country possesses in abundance. A third alternative trade theory focuses on technology, maintaining that the technologically leading country invents new products or techniques, exports the resulting products for a while, and is then superseded as other, less technologically advanced nations take over the product or method once it becomes routinized.

Under the theories of Ricardo and Heckscher–Ohlin, comparative advantage ought to be relatively unambiguous. The product-cycle theory is more ambiguous for comparative advantage, because it expects a temporary advantage of the leading country but at some point a transfer of specialization to technologically less sophisticated countries. A fourth theory, that of product differentiation (associated with Staffan B. Linder),[58] predicts an even more arbitrary process of comparative advantage. Different countries will produce the same range of goods but with product differentiation, and trade will tend to be intra-industry rather than inter-industry. Intra-industry trade is spurred further by the desire to achieve economies of scale by specialization in subcategories within an industry (for example, Grubel and Lloyd).[59]

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[58] Staffan B. Linder, *An Essay on Trade and Transformation* (Stockholm, 1961).

Consider modern trade in manufactures. It is largely irrelevant to the most obvious Ricardian influence of natural resources; thus, steel is not necessarily most efficiently produced where iron ore and coal are found, given modern transportation and the influence of market location. Heckscher–Ohlin trade would probably dominate labor-intensive products such as clothing, if protective regimes did not distort this trade. But for a wide range of products, the relative factor abundance is highly similar across the industrial countries (and perhaps some NICs). As for the product cycle, there is no undisputed leader in technology among the industrial countries: each can aspire to technological leadership in at least some area of manufactures, especially if government intervention occurs. Japan and even some of the NICs have successfully accomplished technological catch-up to the point where, for a range of goods, technology does not provide a determining basis for comparative advantage.

In short, for a broad range of manufactures the country allocation of comparative advantage may be relatively arbitrary, at least among the industrial countries. Intra-industry trade is the logical result of this phenomenon. In a sense, one could view the industrial-country market for a large range of goods as a vast, potentially competitive market where the country location of a particular supplier is largely irrelevant. In this context, the configuration of "comparative advantage" begins to follow more the dynamics of industrial organization (that is, competitive or noncompetitive market structure) usually associated with the closed economy rather than conventional Ricardian, Heckscher–Ohlin, or product-cycle trade. For this range of goods, the conditions of competition may take on more importance than traditional trade influences in determining production patterns. Trade may become more the outcome of strategic behavior by firms than the consequence of national factor endowments. As in domestic industrial organization, considerations such as "who gets there first" take on added importance. A national program to stimulate an industry may cause little trade concern if the country is Norway and the product is coffee or bananas; Ricardian considerations will limit any effects on competitors. National programs to develop industries raise more serious problems for international competition when the country is, for example, Japan or Brazil, and the product is, for example, semiconductors or light aircraft.

In these circumstances it becomes paramount that there be internationally accepted rules of the game for competition, at two levels. First, at the level of national policy, there must be uniformity in what is and what is not acceptable government practice, because governments can affect the competitive positions of their domestic firms. Other things being equal, firms from country A will be at a disadvantage if by national policy country A behaves competitively (no government intervention, except that to correct market failure) while in country B national policy is to administer trade strategically and, in particular, to favor the sector in question. (Of course, other sectors in country B may be placed at a disadvantage because intervention, to be effective, must change *relative* incentives among sectors.) Some forms of intervention may already be subject to international discipline (for example, export subsidies) but others may not (for example, special research programs, exemptions from antitrust legislation, or enactment of special product requirements in public utilities).[60] The imbalance between firms in country A and firms in the favored sector of country B is analogous to that between small, competitive firms and large, strategically behaving, oligopolistic firms (other things, such as country size, being equal). Second, at the level of the firm, international rules of the game are needed for regulating imperfect competition. There is already considerable examination of US antitrust law to determine whether it impedes effective competition by American firms against foreign firms with more leeway for coordinated behavior (for example, in the joint development of new products). Symmetry between national antitrust regulation for international trade becomes all the more important considered in the light of "arbitrary comparative advantage," because competitive dynamics assume a larger role relative to inherent country endowments.

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[59] Herbert G. Grubel and P.J. Lloyd, *Intra-Industry Trade* (New York: John Wiley and Sons, 1975).

In sum, the conditions of modern trade for a wide range of manufactures suggest that comparative advantage may be relatively malleable instead of rigidly predetermined by national endowments of resources and factors, and trade in this range of goods may be determined importantly by the basic conditions of competition and market organization. Strategic behavior by nations and firms influences this trade, and rules of the game are essential if some countries (and firms) are not to be artificially disadvantaged relative to others.

Aggressive reciprocity is one vehicle for addressing the need for rules of the game to govern trade in manufactures with potentially arbitrary comparative advantage. It is probably the wrong vehicle, given the risks enumerated above. But the need remains to develop rules of the game.

There is another, potentially dangerous, implication of the line of analysis developed in this appendix. To the extent that a wide group of countries has endowments of resources, factors, and technology that are broadly indistinguishable, the traditional grounds for welfare benefits from trade are eroded. After all, gains from trade accrue to both parties because of the difference between their respective relative costs of the products. With similar factor endowments, resources, and technology, these differences are not likely to be great, and neither would the losses from reduction of trade. This consideration would suggest that the welfare costs of limiting trade of this sort would not be high. But this inference is dangerous not only because it issues an open invitation to protectionist interests but also because it may overlook important economic welfare effects associated with economies of scale and competitive pressure for technological change even if the static welfare costs associated with comparative costs are limited.

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[60] For a review of government intervention in the high technology sectors, especially in France and Japan, see John Diebold, "The Information Technology Industries: A Case Study of High-Technology Trade," in Cline, ed., *Trade Policy in the 1980s*, 1983 forthcoming. Note that although there is currently government intervention to promote high technology industries in countries such as France and Japan, high defense expenditures have played much the same role in the United States over past decades. In this connection, it is worth mentioning that one classical argument for protection, the need to maintain certain industries for defense purposes, exerts at least some influence in government intervention to maintain the steel industry and perhaps other sectors.

Glossary

CAP	Common Agricultural Policy of the European Community
DISC	Domestic International Sales Corporation. A US international corporation that is permitted to postpone payment of federal taxes on income from export profits until distribution to its shareholders.
EC	European Community. The short-form designation of adherents to the treaties forming the European Coal and Steel Community (ECSC), the European Economic Community (EEC), the European Atomic Energy Community (Euratom), and the treaties amending those treaties. Members are Belgium, France, Denmark, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, and United Kingdom.
EFTA	European Free Trade Association. Current members are Austria, Finland, Iceland, Portugal, Sweden, and Switzerland.
FIRA	Canada's Foreign Investment Review Agency
GATT	General Agreement on Tariffs and Trade
GSP	Generalized System of Tariff Preferences. A worldwide system of national, nonreciprocal tariff preferences in favor of developing countries.
IMF	International Monetary Fund
MFA	Multi-Fibre Arrangement. An agreement allowing participants to limit textile and apparel imports when the importing country considers restrictions necessary to end internal market disorder.
MFN	Most favored nation. The policy whereby a trade concession extended by one country to another is granted to all other trading partners, conditionally or unconditionally.
MTN	Multilateral Trade Negotiations
NIC	Newly industrialized country
NTB	Nontariff trade barrier
OECD	Organization for Economic Cooperation and Development. Members are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States.
TPM	Trigger Price Mechanism. The recent US system of monitoring milled steel imports based on the estimated landed cost of an import from the world's most efficient maker of a given product.
UNCTAD	United Nations Conference on Trade and Development

Chairman **Gibbons**. Mr. Bergsten, only because we are having real trouble, we told all these other panels they would be out of here much earlier, and I have got notice of a conference this afternoon of which I am a member, we are going to have to recess now with your testimony. I appreciate all that you have done. As I said, I wish we had had you as the first witness rather than at the end due to this deadline that we are approaching. You have made a great contribution. We appreciate it. Thank you very much.

Mr. **Bergsten**. Thank you, it has been a pleasure.

Chairman **Gibbons**. At this time, Mr. Bailey, I want to enter in the record a response from the Boeing Co. to the items about domestic content in their airplane, their 767. I just got the letter. The letter is addressed to Mr. Fraser.

[The letter follows:]

The Boeing Co.,
Seattle, Wash., September 29, 1982.

Mr. Douglas A. Fraser,
President, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), Solidarity House, Detroit, Mich.

Dear Mr. Fraser: Thank you for your letter of September 8. We were pleased to receive your comments and questions and appreciate the opportunity to respond to them.

At the outset please be advised that the total foreign content in a 767 airplane is approximately 12 percent of the aircraft value.

In your letter you state that it is your understanding that there is a 40 percent Japanese content in our model 767. I can inform you that the Japanese content on this aircraft is somewhat less than 6 percent of the aircraft value.

The following information, which I hope will be useful to you, provides additional facts pertinent to the Japanese participation on the 767.

(1) Almost all Japanese participation is by contract with Civil Transport Development Corporation (CTDC). This is a separate corporation, established in Japan as the contracting focal point for the work being done by Mitsubishi, Kawasaki and Fuji. Our fixed price contract with CTDC represents a significant participation by the Japanese in the program risk and investment costs of the 767 program. This contributed to Boeing's ability to initiate the program.

(2) CTDC builds 767 body panels for the passenger compartment portion of the fuselage. These panels and the floor structure (which is manufactured in the U.S.) are assembled into body sections by Boeing. CTDC also manufactures the wing-to-body fairings, including the main landing gear doors, and the inspar ribs for the main wing box.

(3) The airlines of Japan have purchased $4 billion worth of Boeing aircraft (164 airplanes, including 25 767's). We are not aware of any requirements for reciprocal purchases or offsets ever being imposed as a condition of Japanese government approval for any commercial aircraft purchases—from Boeing (or any other manufacturer).

(4) These business arrangements were negotiated and finalized long before the 767 was purchased by a Japanese airline. The CTDC contract and eventual Japanese airline orders were never contractually tied together.

In brief, our commercial business with Japan—as a seller and as a buyer—has consistently been conducted according to the free trade and open market criteria we advocate. Our perception is that the Japanese have adhered to the principles of the Agreement on Trade in Civil Aircraft (which among other things identifies offset demands as a trade-distorting practice) even before the Agreement went into effect in January, 1980.

A somewhat smaller contract for 767 work was negotiated with Aeritalia of Italy that is otherwise comparable in all major respects to that with CTDC. There are also some 767 components provided by Canadian, French and British industries. In total, as mentioned previously, the foreign content in a 767 airplane is approximately 12 percent.

I hope these points will be useful in your understanding of our Japanese business arangements.

Very truly yours,

James H. Morrison,
Corporate Director, Labor Relations.

Mr. Bailey. Mr. Chairman, I must profess ignorance on that particular case. My ear did catch the remarks of Mr. Jenkins.

Chairman Gibbons. What I wanted to do really was put it in the record and then go ahead and send copies to Mr. Jenkins and to the other committee members. I may point out for the record at this point that Boeing says that there is a 12 percent foreign content in their 767 airplane, and that 6 percent of that is Japanese, and the thrust of the letter is that they did this for business and economic reasons rather than for any trade reasons, and they point out that there are some——

Mr. Bailey. Mr. Chairman, I wonder in that context if there was any request made of Boeing on the issue of the purchase that you commented on earlier, by Eastern Air Lines of the Airbus. I understand a purchase was due and maybe Mr. Borman could be questioned, on the basis of the financial package and the opportunities afforded by——

Chairman Gibbons. Without objection, we will put this letter in the record, because it responds to Mr. Fraser's questions, and I think it is helpful at this point.

I will also talk to Mr. Borman of Eastern Airlines to find out whether the new Chevrolet is overpriced or whether he is throwing in free flights to help Chevrolet.

Mr. Bailey. I think Chevrolet may not be overpriced.

Chairman Gibbons. That has got to be one of the most humorous things I have seen happen. Rather than either side reducing prices, they are giving you a chance to fly from, for instance, Seattle or Barbados or any of the other countries in the world, or anyplace in the United States, if you just buy a Chevrolet.

Mr. Bailey. I think businesses for years have dealt in everything from loss leader items to advertising campaigns.

Chairman Gibbons. There is nothing wrong with it.

Mr. Bailey. To using up inventories that sometimes, Mr. Chairman—and we will find this with the automobile industry—are more expensive to finance where they are sitting in a lot on the ground than they are to sell at a production cost loss. I don't know the reasons, but I would assume there is some advertising or business goal or objective behind it.

Chairman Gibbons. Nobody likes to cut prices, even when the market says cut prices. So you throw in free glasses. Mr. Borman said this could amount to as much on a flight from Seattle to Barbados, as much as $2,100 on a $4,600 car. Now, either he is giving away his airline or Chevrolet has vastly overpriced their car, but I want to talk to Mr. Borman about that.

Mr. Bailey. I don't know.

Chairman Gibbons. I know Mr. Borman came in here, talked about interest rates in this country, and investments, I remember on liberalized leasing, which was so criticized in the media and of course in the Congress, I must admit that most of it I don't think by folks that had really studied it that thoroughly.

Mr. **Bailey**. I compliment you for compromising some of these issues, but I knew, that Mr. Borman's cash flow could be and has been drastically affected by the recession. A simple statement by Senator Dole about post-February 19, 1982, dispositions of the leasing provisions dried up that market and led to the purchase of a European airplane and the transfer of literally hundreds of millions, if not billions, of dollars worth of jobs, benefits, et cetera. It is not as good an airplane, but the interest rates are lower and they are so desperate for cash flow they didn't have any other choice but to purchase it.

Chairman **Gibbons**. Mr. Bailey, in conference I didn't support——

Mr. **Bailey**. I know that. You did a great job with the Bailey bailout.

Chairman **Gibbons**. And I supported doing away with the safe harbor leasing. I know that might come as a shock to you.

Mr. **Bailey**. No, it doesn't come as a shock.

Chairman **Gibbons**. I lectured the House conferees on the virtues of safe harbor leasing.

Mr. **Bailey**. I know you did. That is why I raised the point. I complimented the chairman for helping in that regard. I am trying to make a point in support of the fact that after study, you were one of the few that had the courage to say, hey now, look at this thing. It's not the way it has been presented.

If I created the impression, let the record show that the chairman was, I think, one of the bright voices, and I mean that sincerely. In light of the many differences we have on other policies, I think it took a lot of courage, given that it was being criticized at the time. If it hadn't been for him, quite frankly, I don't think the groundwork for at least some semireasonable transmission rules would have been laid.

I think you ought to be complimented for recognizing the problem. I happen to be a fan of yours in that regard.

Chairman **Gibbons**. American Soybean Association, Mr. John Baize.

Mr. Baize, we apologize. I thought we would get to you many hours ago.

STATEMENT OF JOHN BAIZE, WASHINGTON PROGRAM MANAGER, AMERICAN SOYBEAN ASSOCIATION

Mr. **Baize**. Thank you, Mr. Chairman.

Chairman **Gibbons**. You represent an important part of America's export business. Go right ahead.

Mr. **Baize**. The American Soybean Association does appreciate this opportunity to be here. We consider the legislation very important.

With the chairman's permission, I would like to insert into the record my entire testimony, which I will summarize.

Chairman **Gibbons**. It will be entered in the record.

Mr. **Baize**. As well as a letter which will be coming to the committee, signed by six agricultural organizations, which specifically states that

> The following agricultural organizations oppose the proposed domestic content legislation, H.R. 5133 and S. 2300, and we urge you to vote against it.
>
> Agricultural exports from the U.S. exceed $42 billion per year, with a favorable balance of trade of more than $25 billion. The imposition of protectionist legislation of this kind could seriously jeopardize that balance of trade, if other countries were then to adopt retaliatory measures which would adversely impact agricultural exports.
>
> We share the frustration of the other U.S. exporters, our fellow Americans and our trading partners around the world over the growing trend toward protectionist actions which would disrupt world trade, but we believe that domestic content legislation is not the proper approach to dealing with those problems. Indeed, we believe that such legislation would be counterproductive and potentially damaging to long-term prospects for expanded world trade.

The letter is cosigned by the American Soybean Association, the National Association of Wheat Growers, National Corn Growers Association, National Council of Farmer Cooperatives, National Farmers Union, and the National Grange.

Anyone that is familiar with agricultural politics would know that to get those six organizations to sign on anything in agreement is significant.

Chairman GIBBONS. I realize that.

[The communication referred to is at p. 839.]

Mr. BAIZE. But in summarizing my testimony, I think that a lot of the others have talked about the technical aspects of trade, and why this legislation, the domestic content bill as it is called, is bad. They have talked about the technical aspects, but I think, looking from our industry and the soybean industry, we look at it more in the commonsense approach.

Soybean producers are greatly dependent upon international trade. This year we will export 55 percent of U.S. soybeans either in the form of soybeans, soybean oil, soybean meal, or a host of other soybean-derived products. The value of those soybeans and product exports will be approximately $8.5 billion. About 20 percent of all U.S. agricultural exports, as America's largest cash crop and this year's highest valued export crop, the soybean sector is enormously important to American farmers, and it is important to the Nation.

We have been able to achieve this remarkable gain in exports because the United States is blessed with a distinct competitive advantage in producing high-quality, abundant supplies of soybeans. Because of the superior competitive advantage, we have been able to supply our surplus production beyond U.S. needs to foreign nations at a price cheaper than those nations could produce them. Buyers in Japan, Europe, and elsewhere have decided to take advantage of the U.S. competitiveness in soybeans produced in the United States and have bought them from us rather than producing them themselves.

In order to gain the foreign exchange to buy our products, however, foreign nations must use the competitive advantages which they have in order to sell their surplus on the world market and to gain foreign exchange to buy our products. It is this concept of trade based on competitive advantage which is in fact the foundation for trade in the international economy.

We believe that the domestic content bill would in one step do more to destroy the world trade than any U.S. action since the Smoot-Hawley Tariff Act. Implementation of the domestic content requirements of the bill would prevent Japan from using its proven competitive advantage in producing automobiles as a means of gaining foreign exchange.

For the period of years that it would take both foreign auto companies to build new plants here and U.S. suppliers to gear up to produce the auto parts required to meet the bill's domestic content requirements, foreign auto companies are not going to be selling cars in the United States. If they can't sell them, they can't gain foreign exchange. If they can't gain the foreign exchange, they can't buy our goods.

I think that is important from the standpoint of agriculture and it's importance to the U.S. economy. Aside from buying seed, feed, and fertilizer, the agricultural economy also buys a lot of capital equipment, a lot of tractors, and combines, and is a major customer of chemical industries. I think it is significant that whether it's a John Deere tractor or International Harvester or both, those truck and auto plants plan to buy a lot of steel, and that farm equipment is produced by the employees in those plants, who as far as I know are UAW employees.

So who would pay the cost of this bill if it were put into place?

First, the American consumer would pay the cost from our perspective in higher priced automobiles produced in an environment of limited competition. Second, American farmers, which collectively sell about $7 billion worth of their commodities to Japan, would pay in the form of decreased demand brought about by Japan's lack of foreign exchange. Finally, the U.S. economy and the U.S. taxpayer would pay through a decline in the efficiency of the U.S. economy.

We have a lot of sympathy, I think, Congressman Bailey, the point you brought up about tobacco today and cigarettes, we see it every day, beef, citrus, almonds, raisins, some of the other items that you cannot export to Japan, and there is no doubt that that country has taken a policy course which is protectionist, but we believe, and we have pursued, and are beginning to pursue more aggressively, the idea that the companies such as Nissan, Honda, Toyota, Sony, and others, whoever ships here have an obligation and they have got to fulfill that obligation to put pressure on the Government in Japan to recognize if they are going to ship their products here, the Japanese Government has to recognize its need to expand its imports.

And in the end, just as in this country, the political forces internally are what decide the policy courses here, it will ultimately be the political forces in Japan which bring that about there.

As for the $30 a pound beef that you pay right now, or the $50 melon, Japanese consumers are beginning to recognize they shouldn't have to pay that much. I think that the foreign auto companies need to be pressuring the Japanese Government, and we are urging them to do it.

I think beyond that, aside from the foreign exchange cost, our deepest concern with this legislation is its significant long-term costs and repercussions. Does anyone doubt that the other economically troubled nations—and I think they all are today—would follow the U.S. lead and establish local content laws of their own? Of course they would.

It is not difficult to conceive of a Japanese domestic content requirement for aircraft or a European domestic requirement for computers. How much success could the United States expect in its current effort to expand value-added exports? These are the processed commodities, whether it is soybean oil, soybean meal, beef, or any of the processed commodities. How much success can we have seeking expansion of that market abroad? In fact, we would be telling countries not to add to the value there. We are going to add it here with American workers.

If you push this bill through, we think that in fact foreign nations are going to say they are going to add the extra valve, and will do so, forcing us to comply.

Our industry is currently in the midst of one of the worst economic crises that we have had; in fact, it is the worst situation since the Great Depression. We can sympathize with the unemployed autoworker, the steelworker, or anyone who has lost their job in this period. We are seeing farmers today who have worked years farming, and seeing their equity eroded every day as they produce soybeans for $7 a bushel and sell them for $5.50.

I agree wholeheartedly with what Mr. Bergsten said this morning. If you are looking at the price in guilders, the price is higher in guilders today than it was when we were selling them for $7 than when we are selling them for $5.50 today because the guilder price is the largest soybean processing center. If you are dealing in Deutshce marks, French francs or whatever, our foreign customers are paying more today at these low prices than they were at $7. It is hard to explain that to a farmer, though.

We recognize that something has got to be done, and we are trying to achieve some solutions to begin restoring economic health to the Nation's economy.

We cannot agree that this legislation is one of the steps to take. Instead of solving the problems, we think it will offer false hope for autoworkers and everyone else, and lost income and jobs for millions of American farmers, workers in export industries and merchandisers of imported products. If the United States wants to solve the problems in the U.S. auto industry, it should seek ways to increase the efficiency and competitiveness of the auto industry.

They have made mistakes in that industry. I think we would all agree that the U.S. auto industry has made mistakes. Maybe it is their unsound investment policy, whatever, but there is the problem.

I have to say that no one is forcing an American to buy a Toyota or a Datsun. They are buying them because they want that car, and that is the bottom root of the problem.

We think that if Congress passes this legislation and limits competition to the U.S. auto industry, it will build in a guaranteed inefficiency in our industry due to a lack of competition.

We are totally opposed to this bill, as is most of agriculture. We recognize the need to do something, but we, like you, Mr. Chairman, feel that there are other ways to do it which are better than eliminating competition and forcing a change in an economy which has built up because one has a competitive advantage in that area.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOHN C. BAIZE

Mr. Chairman, I am John Baize, Washington Program Manager for the American Soybean Association. I appreciate this opportunity to offer the American Soybean Association's comments on H.R. 5133, the so-called "Fair Practices in Automotive Products Act." ASA strongly opposes the legislation and urges its defeat.

The American Soybean Association is a national, volunteer, non-profit, producer-controlled, single commodity association organized to assure the opportunity for a profitable soybean industry. ASA has approximately 20,000 dues-paying members and is supported by over 500,000 soybean producers who voluntarily invest in ASA programs through 23 separate statewide soybean checkoff programs. ASA seeks to maintain soybean profitability through its foreign market development, research, producer and public information, and government relations programs.

Other witnesses have expertly described the litany of technical faults with H.R. 5133. Clearly the technical case against the legislation is immense. Instead my objective today is to point out in common sense terms how dangerous passage and implementaton of H.R. 5133 would be to the American economy, in general, and American agriculture, in particular.

American soybean producers are greatly dependent upon international trade. This year, over 55 percent of U.S. soybeans will be exported as whole beans, soybean oil, soybean meal, and a host of other soybean products. The value of these soybean and soybean product exports will approximate $8.5 billion, about 20 percent of total U.S. agricultural exports. As America's largest cash crop and this year its highest valued export crop, the soybean sector is enormously important to American farmers and the nation, in general.

The soybean sector has been able to achieve this remarkable record because America has a distinct competitive advantage to produce abundant supplies of high-quality soybeans. Because of our superior competitive advantage we have been able to supply our surplus production beyond U.S. needs to foreign nations at a price cheaper than those nations could produce them. Buyers in Japan, Europe and elsewhere have decided to take advantage of U.S. competitiveness as a soybean supplier and have bought ever increasing amounts from us. In order to gain the foreign exchange to pay for our soybeans and products the other nations have exploited their own competitive advantages in other products by selling their surpluses on the world market. It is this trade based on competitve advantage which forms the foundation for the world trade economy.

H.R. 5133 would in one step do more to destroy world trade than any U.S. action since the Smoot-Hawley Tariff Act. Implementation of the domestic content requirements of the bill would prevent Japan from using its proven competitive advantage in producing quality automobiles as a means of gaining foreign exchange. For a period of several years no Japanese automobiles could be sold in the U.S. because it would take that much time for Nissan, Toyota, and Honda to build auto plants here. During this period the Japanese could not gain essential foreign exchange with which to buy the products they must purchase from us.

Who would pay the cost of H.R. 5133? First, the American consumer would pay the cost of higher-priced American automobiles produced in an environment of very limited competition. Second, American farmers—which collectively sell over $7 billion worth of their commodities to Japan—would pay in the form of decreased demand brought about by Japan's lack of foreign exchange. Finally, the U.S. economy and the U.S. taxpayer would pay through a decline in the efficiency of the U.S. economy.

While the immediate costs of H.R. 5133 would be enormous, ASA believes the long-term costs of the repercussions the bill would bring about abroad would be even greater. Does anyone doubt that other economically-troubled nations would follow the U.S. lead and establish local content laws of their own? Of course they would. It is not difficult to conceive of a Japanese domestic content requirement for aircraft or a European requirement to computers. How much success could the U.S. expect in its current effort to expand value-added agricultural exports if this is passed? The answer is, of course, very little since no country is going to let the U.S. add value here when they can use domestic content laws of their own to force the processing to be done abroad.

I could go on and on detailing the reasons H.R. 5133 should be defeated. It is just bad legislation. American soybean producers who are currently in the midst of the worst economic crisis since the Great Depression can sympathize with the pain of U.S. autoworkers. However, we cannot agree with them that this legislation will solve their problems. Instead, it offers only false hopes for U.S. autoworkers and lost income and jobs for millions of farmers, workers in export industries, and merchandisers of imported products. If the U.S. wants to solve the problems in the U.S. auto industry it would seek ways to increase the efficiency and competitiveness of the U.S. auto industry; not eliminate its competition by government regulations.

In closing, Mr. Chairman, I reiterate ASA's total opposition to H.R. 5133. It is a bill which would start a wave of protectionism that will ultimately undermine not only the U.S. economy, but that of the entire world. The bill should be defeated now.

Chairman GIBBONS. I have called the bill a great socialist idea. I think you put your finger right on it. This is the difference between freedom and compulsion. I don't have to eat your soybeans and I don't have to buy Mr. Bailey's car, but if the Government is going to step in and say I have got to eat your soybeans, I have got to drive Mr. Bailey's car, that is just the difference between our society and other societies.

I think this bill goes to the fundamentals of this country. I have said that this is the worst piece of economic legislation that I have seen in 50 years. I might say it is the worst piece of economic and social legislation that I have seen in 50 years. I can't understand the rationale in any American's mind for really wanting to pass this bill.

This is saying to some parts of America, you are going to be slaves; you don't have the freedom to make a decision. I pull no punches on this legislation. I appreciate you coming here and putting your finger right on the essential differences that we have.

Mr. BAIZE. I would just reiterate that our industry, the soybean industry, more than any other agricultural commodity sector, has evolved out of a free market approach. Unlike the other major commodities, there are no expensive Federal programs for soybeans.

Chairman GIBBONS. You don't ask for Federal support or anything, do you? You take your risk in the market?

Mr. BAIZE. We take the risk in the marketplace. It has evolved in the soybean industry. Basically, in 1930 there was no U.S. soybean industry, but today we are the second largest acreage, the highest valued domestic crop. Soybeans are a crop with which farmers recognize the potential to make money, so they grew it. Now we have got 73 million acres, and about 600,000 soybean producers today.

This bill would cause a serious setback for the U.S. soybean industry. We also look back to 1973, a period you remember.

Chairman GIBBONS. Yes, sir, the Nixon shock.

Mr. BAIZE. The Nixon shock on exports of soybeans, which singlehandedly built our competition in Brazil and in Argentina.

Chairman GIBBONS. It did great damage to your industry, more than any one thing the Government has done.

Mr. BAIZE. From my perspective, yes. In 1974 and 1975 we had two other relatively short embargoes against the Soviets and Eastern Europe.

A repercussion of the Carter embargo is that foreign soybean customers don't trust us anymore as a supplier. We might make it if we just didn't have our own Government doing things to us. Our farmers look at this bill and they see in fact the manifestation of yet another onerous Government action. It would discourage our foreign buyers from purchasing our Soybeans, since they probably won't have the money to buy them, and unlike other industries, we can't sell all our production here at home. You just can't eat that much more here. It has got to go somewhere, so if foreign customers don't have the money there, I don't know what we are going to do with our tremendous grain production.

Chairman GIBBONS. I think your industry best typifies the philosophy that I espouse: Don't fritter away your resources, reinforcing your failures.

Mr. BAIZE. Grow what you can.

Chairman GIBBONS. Exploit your successes. That is the American way to do things. I don't think we ought to follow Japan or those socialist economies of Europe, but obviously there are some members who think we ought to follow great national socialism, and we see day after day what is happening to their noncompetitive economies, social unrest, political unrest, and even economic collapse.

Mr. BAIZE. Especially in agriculture.

Chairman GIBBONS. They say we ought to follow them. Look what they are doing. They are saving their steel industry, yes, as everybody else is in financial trouble over there.

Mr. BAIZE. I think if you look back to the era of the middle 1800's and earlier than that in fact, that the port of Odessa now in the Soviet Union was a major exporting point for grain to Europe. Now it is a major importing port, and we recognize that if in fact that economy was released and the farmers there could produce what is in a relatively capitalistic economy there wouldn't be a market there.

Chairman GIBBONS. That happens to be the best illustration of an industrial policy that I can think of. The Chinese also had an industrial policy all planned by those great thinkers in their central government, and that is the kind that some people would foster upon us.

Mr. BAIZE. That is what we see in this bill.

We recognize, I think, the point that Mr. Bergsten was getting at, is the bottom problem, the currency evaluations.

During this world economic recession, our exports of soybeans are up 31 percent in volume over a year ago.

To compete, our price had to drop.

We had to sell the soybeans at a lower rate relative to the Brazilian currency.

Chairman GIBBONS. You did not have to give away a $2,100 flight to Barbados to sell your product?

Mr. BAIZE. The world market cut the price. A bushel of soybeans is worth what the world will pay for it. That is all.

Chairman GIBBONS. So is a Chevrolet.

Mr. BAIZE. That is what has happened to us. Our farmers are on the verge of bankruptcy in many areas, but to get out of this we have got to sell and get demand pulled up relative to our supply. You have to establish the market.

Chairman GIBBONS. Is it any less painful for a soybean farmer to cut prices when their product does not sell, than it is for an industrial producer to cut prices when their product won't sell? Why can a soybean farmer sitting there, with all kinds of payments coming due, cut prices, when a big industrial empire with lots of political clout comes to Washington and says, we can't cut prices; we need more protection?

Does a soybean farmer bleed any less?

Mr. Baize. I would say that he—he does not bleed less than an autoworker who loses his job, but he bleeds a little less than the head of a corporation who does not own the company.

When the farmer, in fact, owns that land, it is his equity that he has built up that is gone.

Chairman Gibbons. The auto executives lost their bonuses. I really bled when they told me they lost their bonuses and got their salaries down to $400,000 a year.

My heart was broken when they told me that they had lost their bonuses.

Mr. Baize. I have got one farmer in particular that I can think of that 5 years ago was a very prosperous farmer, owned all of his land, was in good shape, brought a son into the operation, and he was hit with 2 years of drought and now the world prices, and the embargo. Today, he is, in fact, 80 percent mortgaged of that equity that he once had all.

He is a man that does not have a lot of patience for the future.

He recognizes that the problem is today, but, at the same time, he is the same one that is saying stick with the policy you got; the market-oriented approach, because that is what got us profitable before, and it is the only thing that is going to get us out again, but that is the problem.

We just believe, let us get out of it, just don't let our Government keep us from getting out, and that is what we perceive H.R. 5133 would do.

Chairman Gibbons. Mr. Bailey?

Mr. Bailey. Tell me, do soybean farmers grow other crops?

Mr. Baize. Corn in the Midwest.

Mr. Bailey. Well, they grow other things, and look at commodity markets and look at what is selling. Very few of them go out there and turn over 1,100 acres to soybeans—that is, all their acreage—and put all their eggs in one basket.

Most of the farmers I know, they sit down and make those kinds of decisions as businessmen.

Is that what your farmers do?

Mr. Baize. Generally, yes.

Mr. Bailey. We should not talk about soybean farmers like we are talking about Ford manufacturing a line of cars. We are not really talking about a fair analogy, but really two different things in a way.

Mr. Baize. Well, I think that——

Mr. Bailey. I don't want to sound condescending. You get my point?

Mr. Baize. There wouldn't be a whole lot of difference between the farmers you describe and a Ford dealer who also owns a Datsun dealership.

Mr. Bailey. We are talking about a nation and an industrial capacity.

I have sat through 2 weeks of this hearing, and I am getting sick and tired and fed up.

I should not use you as a vehicle to vent that frustration, but we have established a dialog hopefully that is mature and reasonable in terms of what some of the causes are.

You know, we can criticize and play to the audience on issues like what executive salaries are.

It may be because we are irritated that we are not paid that well, I don't know.

I don't know the reason for that. It is silly. It has reached the point, what are we getting at here? When you look at our agricultural industry and its successes, you are talking about a certain creature, and when you look at the manufacturing sector, you talk about different problems of supply—both vastly complex, and very different—and to talk about a commodity like soybeans, for example, and talking about being subsidized or not, belies the availability of all kinds of things to farmers that grow a multitude of products of which soybeans is a mix. Is that not correct?

Mr. Baize. Correct.

Mr. Bailey. I am not criticizing you, and you are presenting a point of view.

I was on a tractor, and very much considered going into agriculture when I went to school, and I had a little more knowledge than the absolute absurd simplicity of describing the soybean agricultural sector the way it has been here. It is fine. I think quite frankly, if you are talking about soybeans, we all know why soybeans are raised.

They are a very, very high protein source and as such represent not only a valuable protein source for human beings, but—and correct me if I am wrong—represent a very valuable feed source, do they not?

Mr. Baize. That is the primary usage.

Mr. Bailey. Because, when we sit down there and look at that beef on the hoof, and you have to go out there and sell that thing at $40, and $50, and $55, $100 on the hoof, as you and I know, at those auctions, I don't know what the prices are now, but I have been there, I know what that farmer is talking about when he converts his gasoline, his fertilizer, his seed, into every little pound of beef he can put on that hoof.

You are an expert in that field. You want to sell more soybeans so you can sell more beef in Japan.

Do you think the Government ought to help you hit the Japanese over the head so they stop this artificial barrier to your soybeans in that regard?

Mr. Baize. We think the Japanese import system on beef definitely should be liberalized.

Mr. Bailey. I agree with you, and it maintains an artificially high barrier.

The fear is that great Japanese taste for beef is going to create a consumption if it were brought in at reasonable prices that is going to send a lot of money out of that country; yes, sir. They want that beef, but at 19 and 20 bucks a pound? And how long have you been fighting that problem? How long has it been?

Mr. Baize. We have been fighting that problem ever since World War II, I guess.

Mr. Bailey. Ever since World War II, the Japanese consumer who wants to eat beef and the American farmer that wants to grow it and wants to grow the soybeans that enables him to efficiently put the protein into that animal to meet that consumer choice, has faced frustration and barriers that have been a deliberate part of policy in Japan.

Mr. **Baize**. Sure.

Mr. **Bailey**. I am going to tell you something, and we don't agree on the end result of this legislation, but I have studied problems like yours, and I appreciate them. I hope I have been able to demonstrate my knowledge of what you have been up against to your benefit, and it is because of those kinds of policies that this bill is being used as a forum, albeit a poor one to press a point.

I want you to know that, and inside yourselves, you know it does not represent a hostility to you or to your industry. Quite frankly, if the Japanese would wake up and be a little more fair, then the arguments in support of this legislation would not be there, because the pressures against this international system of trade which would benefit you have got to come down.

Mr. **Baize**. Sure they do.

Mr. **Bailey**. To be so naive in the face of an incredible weight of evidence as to criticize American economic participants as responsible for that policy is wrong. That is not fair, because Americans have not created that problem in Japan. We have tried to use persuasion. We have tried to use reciprocal agreements to encourage, and cajole, and open up markets.

Most of us realized these things were going to happen.

I know a balance has to be struck between American defense responsibilities and American industrial capacity.

John, I want to say this to you: If I thought that you could, even in a free world completely devoid of international security problems, compare manufacturing sector economic difficulties, government relations, and problems with the agricultural sector, I could at least give way to that argument that an industrial policy is somehow some form of socialism.

I thought that debate had been ended many years ago in this country. We all know we live in a world of mixed economies, and we have to do a certain amount of support in agriculture.

The chairman very correctly referred to the issue of milk this morning.

There has got to be some sort of support mechanism or you lose the capital investment that you can't replace.

For example, holstein cattle on the hoof represent a capital investment that is valuable to this country. That is an investment. They are living sources of a tremendous nutritious sort that we need, and when we let that market fall apart and do not support it, socialism in its finest, at its finest, that investment in those cattle will die because we will go out there and eat holstein cattle—and those milk cows bring in a ton of money.

You get a good milk cow; she is one valuable investment. We eat a heifer as much as we like beef, as inferior as she is to the others, as we know, and convert your soybeans a little more efficiently, well, we don't want to do that, so we engage in socialism. I don't think that is realistic, and that is why we have not been able to write good regulatory policy, and that is why we have had trade failures.

I don't like this particular bill for a lot of reasons, looking at it in isolation.

I have been honest about that in these hearings.

I am asking you for a suggestion. What would you do with our manufacturing sector if it looked like we were going to lose the capacity to produce automobiles, and our vehicle industry from a military point of view, shoes, mining? What would you do?

I don't know, short of some form of guarantee or protectionism, I don't know honestly; but what do you do?

Mr. **Baize**. From the standpoint of national policy, if, in fact, you feel it is essential to have certain sectors, certain capacities, to produce in a period of need, and nations, then you should build the associated costs into the Federal budget as an outlay, just like you do with your defense appropriations.

You are saying we need it, the capability.

Mr. **Bailey**. Part of this problem is a certain defense capacity. We need to look at it in that context, and I think two things would rob us of arguments in favor of this bill.

One would be really fair treatment in terms of our relationships with other countries, and the second would be the assumptions of defense responsibility that would cause resource allocations that we are forced to make.

We divert valuable human and material resources to our defense establishment that other nations do not, and if those two criticisms were not there, you could not support this bill. Arguments can be made for it on other bases, and that is where I am coming from.

Mr. **Baize**. In the end, I guess I suppose it would be a perception that ultimately any industry, to exist, has got to be worth the cost that it takes to keep it, if it is a competitive industry.

Until 1970, in fact, the American automobile industry was unmatched anywhere.

Mr. **Bailey**. The market changed drastically because of the oil situation, which also affected you on the farm.

When the arguments come in on allocation, John, believe me, old Don Bailey is one of the first people to argue that those farmers have got to have that tractor fuel. I know what the big International Harvesters take to run their engines. It takes a lot of fuel to turn that dirt over, especially when a farmer is pushing 1,000 or 1,200 acres for every one of those tractors every year. Socialism at its finest.

Mr. **Baize**. I agree that no one is pure.

Mr. **Bailey**. I recognize this bill is a very poor policy response when viewed in isolation, but when viewed in context, it will serve to get some attention. I hope before it is all said and done that you find a great market for that beef and those soybeans in Japan, and that was not there before, because out of this dialog is going to come something positive, and that is a recognition of severe problems that we have.

Mr. **Baize**. We would agree with that, and I hope that out of this dialog we can reach a policy that says that the United States has to recognize that we are competing in a world market, which also means that we have to compete here and abroad. Our Government has aggressively pursued a policy externally to pursue or push our products abroad, not aggressively enough.

I think it can. You mentioned the Ex-Im Bank.

Mr. BAILEY. That is one of the points that I have been talking about.

We got in a discussion with the prior witness, on so-called industrial policy and export finance policy, particularly with financing.

As an example, you talk about subsidization; we sat down with some Thais a year ago complaining terribly about American rice policy subsidization.

You get those kinds of complaints and many members have raised the issue; we are not in there talking with a clean slate, either. That is 100 percent true, and they also make a proper criticism of this legislation: two wrongs don't make a right.

But what we have to do is come up with reasonable alternatives that decrease the pressures so that you can freely go over and market and sell your product. You can't do that, and that is unfair. Quite frankly, our manufacturing sector has been encouraged by all kinds of incentives to invest abroad, and they have done it. They have never been able to do it in Japan.

Now, the Europeans, and it is not known here very well, they also attempted to establish manufacturing facilities and to move into that market and operate in it.

The reason, the justifications, raised against the Japanese today in European markets in their manufactured products, are precisely what have been raised here; and I am sympathetic to your problems, though.

Chairman GIBBONS. I hate to interrupt. We have an important vote on.

Mr. BAILEY. I am finished, Mr. Chairman.

Chairman GIBBONS. You want to come back and ask him some more questions?

Mr. BAILEY. No. I am finished.

Chairman GIBBONS. Thank you very much, sir.

The committee will reconvene tomorrow at 9:30. Excuse me, 10 o'clock.

I have asked the staff to notify all members that I am calling a session for tomorrow afternoon at 2 o'clock to take up this and other bills that are before the subcommittee, and I hope all members can be present.

The meeting is adjourned.

[Whereupon, at 1:55 p.m., the subcommittee adjourned, to reconvene at 10 a.m. Friday, October 1, 1982.]

FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT

FRIDAY, OCTOBER 1, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 10:20 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman **Gibbons**. Good morning, ladies and gentlemen. The meeting of the Trade Subcommittee of the Ways and Means Committee will resume.

Our first witness this morning is from the U.S. Department of the Treasury, Under Secretary for Monetary Affairs, Mr. Beryl W. Sprinkel. He will arrive at 11.

We will start with Mr. Jack Baranson, president of Developing World Industry and Technology, Inc.

Mr. Baranson will be discussing for us this morning the relationship between the Japanese Government and the Japanese auto companies. Mr. Baranson has also been studying Japan's increasing use of robots.

Good morning, Mr. Baranson.

STATEMENT OF JACK BARANSON, PRESIDENT, DEVELOPING WORLD INDUSTRY AND TECHNOLOGY, INC.

Mr. **Baranson**. Good morning, Mr. Chairman.

Chairman **Gibbons**. Mr. Baranson, you may proceed as you wish.

Mr. **Baranson**. The remarks I prepared for this morning are based on the research that we have done for several Government agencies over the last 2 or 3 years; the initial work on the strategies and position of the Japanese automotive industry was done for the Federal Trade Commission.

Later we did more extensive work on questions of technology and trade policy for the Special Trade Representative which we completed last October, and at that time we were able to update the material on which the remarks I am making this morning are based.

I have given to some of your staff a copy of a chapter of my book on "The Japanese Challenge to U.S. Industry," and the remarks I am making are drawn from chapter 10.

Chairman Gibbons. Yes, sir, I see that. I am sorry I have not had a chance to read it yet, but I will. Do you want to review that for us?

Mr. Baranson. What I would like to do is briefly touch on the high points.

Chairman Gibbons. All right, sir.

Mr. Baranson. I gather that part of the committee's hearings addresses itself to the current difficulties of the U.S. automotive industry, its declining share in U.S. markets, progressive erosion in foreign markets.

One consequence of foreign competition has had a flattening of car prices. There are also rising production costs—labor costs in this country probably run twice of what they are in Japan. This has resulted in diminishing revenues of automotive companies and their profits and consequently reductions in financial resources to recapitalize the threatened industry, an industry that is now seriously threatened by foreign competition.

The arguments that have been put forth are that part of the underlying reason for the Japanese success here in our markets is a history of protectionism, government intervention, and cartelization of the Japanese industry. As a consequence the United States needs to develop some countervailing measures in legislation involving protectionism, quota restrictions, or the local content laws that have been proposed, to redress the balance and hopefully revitalize the U.S. industry now.

Based on work we have done, indications are that this is both a wrong diagnostic of the Japanese challenge, and the prescription for U.S. industry is probably even of more negative consequences.

A more accurate diagnostic on the Japanese automotive industry is that the Japanese Government did nurture the industry in its early stages, beginning in the 1930's, when by the way U.S. firms had 85 percent of the Japanese market—Ford and other companies were assembling and distributing cars. It was during that period and following World War II that the Japanese Government undertook very definite measures to nurture the industry in the early stage of its development.

As the industry gained strength the Japanese Government gradually and progressively withdrew support. The point is that during the infant stage there were very definite measures that are very carefully documented in the automotive chapter of our book as to the nature and extent of this subvention.

But certainly by the midsixties when the industry had reached international competitive standards, this subvention was largely withdrawn.

Japanese competition is based on the essential efficiency and competitiveness of their industry, based on constantly expanding production volumes; ever improving product designs; progressive technological upgrading of plant and equipment; and a very, very strong and supportive supplier industry which is highly responsive in terms of changes in markets and cost effectiveness. This very effective industrial strategy is backed by: (1) a highly aggressive and competent industrial management; (2) a highly productive and properly motivated labor force; (3) a favorable economic and financial environment that provides debt leverage and financial structures to encourage long-term capital investment; (4) constant persistent investment in innovation; and (5) a government providing complementaries that perceive oncoming economic and technical change and react in an appropriate and timely fashion. This is what the Japanese call their visions, and what it means is not to lock the barndoor once the horse is out that anticipate changes in the world economy years before hand. These visions usually have a 10-year perspective, ahead of seeing what economic and technical changes are occurring in the world and recommending appropriate joint action by government, industry, labor, and financial institutions.

From the foregoing, I draw the following implications, I think, for legislative action, for U.S. policy more broadly defined. The answer certainly is not in movements toward more protectionism. So my first point is that only the forces of competition that can relieve the difficulty our industries are in, rehone them to the competitive positions that they once held. Second, we need economic policies that better balance the channels of savings and revitalizing investments, better management of supply and demand for money to bring interest rates down, and financial markets that are attuned to the innovative process. Anyone who studies economic events in Japan over the last 15 years particularly, cannot go away but impressed by their very, very effective and constant attention to this environmental factor. That probably is the real "subvention" by the Japanese Government.

In visiting Japanese automotive factories, one finds that the laborer earns half of what he does here, and instead of working an effective 1,100 hours a year is working closer to 1,900 hours. The third sort of guideline becomes fairly evident. Americans just have to work harder and be more productive and see economic activity as a common cause the way the Japanese do. Fourth, labor, management, and government see this in Japan; they know that if they do not hang together they cannot survive in the world. One does not find in Japan the pervasively adversary confrontation between labor, management, and government which we constantly see. These hearings I am sure in part are the presentations of adversarial positions, Mr. Chairman, rather than an effort to judiciously and perhaps with insight and perspective attempt to understand the nature of the problem and to come to some common solutions.

Finally, as a society, we have to plan more effectively for technical and economic change. I use purposely the word "plan" because I know it is an anathema to many in the current administration. Yet this is what is necessary. We need to think about our difficulties in the commonality and address ourselves to them in this frame.

There has to be a more effective harmonization of commercial corporate interests, economic and trade policies, and the response of financial markets—all aimed at a substantially higher level of innovation.

Dynamic innovation is the salvation of the American economy. The cost of protectionism unquestionably is not only a step backward; it may be the road to disaster economically for this country.

As I said, Mr. Chairman, I have avoided burdening you with details. I assure you that the written material has a good deal of chapter and verse on the points I have categorically stated. There is a good deal of mythology about Japanese cartelization, protectionism, and subvention. The Japanese Government—those who manage the economy—want to make sure that the resources are available; that the trade policy is right; that interest rates are not too high; and that exchange policy does not adversely affect the export trade. In short, responsible Japanese Government officials are continuously looking at these elements and trying to make sure that the economic environment is favorable.

Unquestionably in the early infant stage, they saw to it that the infant industry was not challenged by large foreign corporations, but ultimately the Japanese industry has survived, thrived, and made the inroads that it has today based on intensive competition inside the Japanese economy. The biggest competition that Toyota and Nissan, the leading automotive firms, get are from other Japanese companies. That is what has given Japan its competitive edge.

It would be very, very, counterproductive for a grown, mature industry to revert to protectionism,.

[The material referred to follows:]

TEN COMPETITIVE UNDERPINNINGS OF THE AUTOMOTIVE INDUSTRY

In many ways the corporate strategies of Japanese automobile manufacturers parallel those of the Japanese consumer electronics industry. Both industries are committed strongly to long-range management of technological resources; Japanese automobile and consumer electronics firms, for example, expend relatively large amounts of funds annually for R&D and redesigning and reengineering work, which is promoted by a favorable tax environment. Both industries' production strategies call for increasingly automated, high-volume, onshore production; lower per-unit costs and higher-quality products are the twin objectives. Integral to a manufacturing strategy calling for increasing production volumes is an aggressive, imaginative drive for export markets to absorb higher output levels. (Japanese industries have been aided in this in recent years by an undervalued yen, due to the country's high oil bill.) Finally, both industries benefit from their relationships with their respective supplier industries, which are composed in general of responsive, inexpensive subcontractors. The corporate policies that have brought success to the Japanese consumer electronics industry are not restricted to that industry.

PRODUCTION AND MARKETS

The Japanese automobile industry has now replaced the U.S. industry as the world's leading producer of cars; its output in 1980 was 11,042,844 vehicles. For the past several years the Japanese automobile industry has been intent upon surpassing its U.S. competitors, and growth in Japanese production volumes reflects the determination to achieve this goal. From 1975 to 1979, the Japanese industry enjoyed an average annual production rate of over 8 percent. At a time when U.S. automobile manufactruing facilities are suffering from underutilization, Japan's total automobile production capacity will expand to 12 millon units by 1982, a 30 percent jump in capacity from the 1978 level of 9.3 million units.

The Japanese automobile industry is extremely competitive, with nine domestic manufacturers, the smallest producing over 200,000 vehicles annually. Because the domestic vehicle market is close to the saturation point, the Japanese automobile industry was faced with the choice of either aggressively seeking export markets or rationalizing production to a greater degree through mergers or acquisitions, and in fact, several of the smaller automakers are affiliated with the larger manufacturers.

Since 1960, two companies, Toyota and Nissan, have dominated the Japanese industry, accounting today for two-thirds of the production of passenger cars and slightly over one-half of the production of commercial vehicles.

Toyota is Japan's largest vehicle producer and is the third largest automobile firm in the world, behind General Motors and Ford; annual production in 1978 was 2.5 million units. Nissan, the maker of Datsun vehicles, is Japan's second largest automobile firm and fourth largest in the world, with 2.3 million units manufactured in 1978.

In descending order Japan's other major vehicle manufacturing firms are (1978 world ranking and production figures in parentheses): Toyo Kogyo (eleventh largest, with 717,000 units); Mitsubishi (thirteenth largest, with 648,000 units); Honda (sixteenth largest, with 560,000); Isuzu (twenty-fourth largest with 335,000 units); Daihatsu, which is affiliated with Toyota (twenty-seventh largest, with 261,000); Fuji Heavy Industries, which makes Subarus and is affiliated with Nissan (thirty-second largest, with 241,000); and Suzuki (thirty-third largest, with 202,000 units). In line with the trend toward a concentration of production in the world automobile industry, Suzuki is expected to be amalgamated into the Toyota group, Mitsubishi is linked with Chrysler, and Isuzu with General Motors.

Individual Japanese firms in general produce a range of vehicles from the minicar to medium-size sedans. Although the domestic market has traditionally favored smaller-sized cars, the Japanese automakers also make their initial inroads into export markets with cars of this size. In an attempt to capture larger shares of export markets, the Japanese auto firms are expanding their product line to include larger vehicles. In West Germany, for example, two Japanese firms offered 12 models in 1975; by 1979 five firms were offering 28 models and 122 variants. (This phenomenon also occurred in the Japanese penetration of the U.S. consumer electronics markets.) Buses and light commercial trucks are also becoming a significant export product for Japanese manufacturers.

The domestic automobile market has been extremely important to the Japanese manufactuers and, like the consumer electronics market, was protected in the developing stages. The industry as a whole exports about 48 percent of its output, as compared with the export of 52 percent of the output of the French and West German industries. Japan is the second largest automobile market in the world, representing over 8 percent of this market, behind the United States, which accounts for just over 40 percent. At present, there is approximately one car for every two people in the United States. Yet while the domestic market remains an important commercial battleground for the Japanese automakers, especially for the replacement market, it is becoming increasingly apparent that the long-term success of individual Japanese auto manufacturers hinges on their continued ability to expand into export markets. The Japanese market is expected to stabilize in the early 1980's due to sheer geographic absorption, thus making export markets the principal outlet for expanding production volumes.

Since 1974 Japan has been the world's largest exporter of automobiles. By 1979 the Japanese industry was exporting over 4.5 million units (as compared to 2.6 million in 1974), far outpacing France, its nearest international competitor, which exported 2.43 million units in 1979. Japanese exports have been rising steadily over the past few years, and the industry continues to announce expansion plans. Given the inability of the domestic market to absorb the projected production increase, there is a compulsive necessity to continue to expand exports. With roughly 40 percent going to the United States, this represents the largest single export market for Japanese firms.

Although the Japanese industry is aggressively attempting to expand its share of the U.S. market (over 20 percent in 1979), it is also conducting intensive marketing campaigns throughout the rest of the world. More than any other national automobile industry, the Japanese industry's export activities span the globe. In the ten years from 1969 to 1979, Japanese automobile exports increased by over 480 percent. To put this in perspective, exports in 1977 to the United States totaled 1.7 million vehicles; they increased 76 percent by 1979, totaling over 3 million units. In 1977, exports to Europe came to 760,000; Southeast Asia, 470,000; Middle East, 437,000; Oceania, 296,000; Central and South America, 273,000; and Africa, 262,000.

On the other hand, automobile imports into Japan remain minimal, a result of both the strong hold maintained on the market by Japanese firms and the nontariff barriers (including a complex distribution system), which have made the market all but impenetrable in the past to foreign firms. Also imports into Japan frequently fail to measure up to quality expectations or demands of Japanese consumers; certain specifications are often lacking. No U.S. auto manufacturer, for example, produces right-hand drive cars, and Japan, like England is a right-hand drive country. As another example, Japanese consumers generally feel that the paint job on U.S. autos is inferior to that of Japanese cars. Imports for the past several years have never exceeded 2 percent of national new-car registrations. In 1979 approximately 17,000 U.S.-made automobiles were sold in Japan, as compared to the 2 million Japanese vehicles sold in the United States that year, and total Japanese imports of foreign cars in that year were just over 60,000 units.

HISTORICAL DEVELOPMENT AND GOVERNMENT INVOLVEMENT

The Japanese automobile industry was insignificant up to the late 1930's and did not become international in scope until the 1970's. The shape and directions the industry has taken in more recent times are influenced by a number of historical forces: the threat of foreign competition, the role of the government, and the national trade balance.

In the 1930's Ford and General Motors controlled 85 percent of the Japanese passenger car market, producing over 30,000 units annually from parts and subassemblies imported from the United States. The domestic industry achieved very little growth, composed as it was of very small firms operating with inferior scale, technology, and capital resources; annual production did not exceed 500 units before 1930. That automobile production fell to the strictly private, small-capital sector was due in large part to an absence of Japanese government interest in fostering a domestic industry. In the government's view, automobile production was a highly speculative enterprise and of lower priority to the national interest than steel, coal, and other heavy industry. This view was shared by the powerful and diversified zaibatsu groups of Mitsubishi, Misui, and Sumitomo, each one of which separately considered and rejected entry into the automotive business. (The zaibatsu organization was a very large holding company, which was generally controlled by a wealthy family clan. An individual zaibatsu formed a collection of manufacturing, trading, and financial corporations. A handful of these zaibatsus were a dominant force in the pre-World War II Japanese economy. Some of the present-day large corporations trace their lineage to the pre-World War II zaibatsu period, but in contrast to the prewar groups, they are loosely linked to associated business groups, both legally and managerially.) Because of this, a large number of small manufacturers were able to gain a significant portion of the growing automotive market in Japan.

During the 1930's the government's attitude toward an automobile industry changed, in part out of a recognition that its military ambitions in Asia required production of heavy vehicles. In addition, then-current long-range economic consideration pointed toward the need to articulate some form of national automobile development policy. While still harboring strong doubts as to the economic wisdom of fostering a domestic industry, the Japanese government nevertheless was becoming increasingly aware that if onshore foreign capital was permitted unlimited production levels, it would continue to dominate the domestic market and hence preclude development of Japanese producers. The high failure rate of small domestic producers and the continued unwillingness of the zaibatsus to compete, even at the later invitation by the government, convinced economic planners that protection from foreign capital was essential for the development of domestic industry.

Another dimension in the government's reconsideration of an automobile industry was Japan's foreign exchange situation, whose precariousness was dramatically underlined by the international monetary crises and trade dislocations of the late 1920's and early 1930's. The lack of a domestic automobile industry placed strong demands on the country's foreign-exchange reserves to pay for imported finished vehicles or parts for assembly. Domestic automobile assembly and parts manufacture would reduce net imports and provide much-needed industrial employment and income.

This awarness was translated into policy in 1936 with enactment of the Automobile Manufacturing Enterprise Law, designed principally to curtail the activity of foreign producers onshore and to stimulate domestic producers. The law imposed annual production ceilings on foreign producers, and the tariff rates on imported parts were raised. In 1937 a provisional law eliminated imports of strategic commodities. Soon thereafter the combined laws had their desired effect; Ford's and General Motors' penetration decreased dramatically.

To Japanese producers, the law extended a variety of generous benefits, including exemption from income tax for five years, a five-year rebate on import customs duty, and a relaxation in the legal requirements for recapitalization By 1937 Nissan and Toyota, along with the truck manufacturer Isuzu, dominated automobile production in Japan with a combined 80 percent share of the national market. A negligible number of passengers cars were made in the prewar period, with buses and trucks (one-half of which were consumed by the military) constituting the major portion of production. The year 1938 marked both the peak year for passenger car output (2,000 units) and the point at which automakers turned increasingly to military vehicle production.

The question of whether Japan should have its own automotive industry was again debated within the government for several years after the war. The newly formed MITI argued for redevelopment of the industry, with an emphasis on passenger car production, based on foreign technology and government financial assistance. The opposing point of view, represented by the Bank of Japan, asserted that the scarcity of capital and immense reconstruction task ahead dictated that Japan concentrate resources into areas of comparative advantage, which did not include automobile production. Both sides realized, though, that demand, at least in the short run, would be met through imports; the reentry of foreign capital, however, was never considered as an alternative.

Although these opposing viewpoints were based on different principles—the former sought infant industry protection, while the latter was based on the theory of comparative advantage—they both shared the recognition that the Japanese automobile industry at the time was far behind those of the industrially advanced nations. The scarcity of automobiles in Japan and the expectation that the foreign-exchange constraints would continue gave considerable weight to the arguments advanced by MITI and its supporters. The matter was finally settled by the Korean War, since the automotive needs of the United Nations forces created a timely growth opportunity for Japanese producers. The automobile industry was thus placed under strong government protection as one of the economy's strategic industries, along with synthetic fibers, petrochemicals, and electronics.

Government protection for the industry consisted of quotas, tariffs, and commodity taxes. Although a quota system for automobile imports had been in effect since the end of World War II, by the early 1950s its chief function had changed from the original one of conserving scarce foreign exchange to protecting the infant domestic automobile producers from foreign competition. Japan's tariff rate structure was both high overall and designed to favor domestic producers. For example, tariff rates were much higher on smaller passenger cars than on trucks and larger cars, where Japanese producers were either fully competitive or not competing at all. In addition, the commodity tax structure discriminated predominantly against foreign, large cars in an effort to shift demand to Japanese models. Having removed quotas in 1965 and eliminating soon thereafter most of the tariffs and commodity relief enjoyed by domestic manufacturers, the government today retains little of this protectionist machinery.

Recognizing the strategic role it could play in the economy as a whole, the Japanese government in 1951 also took special steps to provide the automobile industry with the necessary capital for expansion and modernization through special tax arrangements and subsidies. Later the auto parts industry was included under these same provisions. On MITI's recommendation, the Japan Development Bank extended a series of reconstruction loans to the auto producers during the period 1951–55. The value of these transactions to the industry far exceeded the monetary value of the loans (which were of nominal amounts) in that they served as a demonstration of the government's support of the industry and thereby encouraged commercial banks to extend credit as well.

It soon became evident to both the economic planners and the companies themselves that no amount of protection and financial support could compensate for the low technical level of the Japanese auto manufacturing capabilities. There was a consensus that foreign technology needed to be obtained, and MITI selectively began to approve applications from the auto companies to assemble knock-down imported components from foreign, primarily European, manufacturers. In 1952–53, four domestic firms negotiated individual five- to seven-year contracts: Nissan with Austin of the United Kingdom to assemble 1,200 units a year; Isuzu with Hillman, also of the United Kingdom, to assemble 1,200 units annually; Hino with Renault to assemble 1,300 of the French vehicles annually; and Mitsubishi with Willy's Jeep.

Nissan was the only company of the four with previous experience in passenger car production. In fact, it was largely the decision to license technology from abroad that permitted existing truck manufacturers in Japan to enter passenger car production. Toyota and Prince, however, depended exclusively on domestic expertise, and the four licensees were soon in a position to upgrade their own technology. The assembly of European knock-down cars lasted a relatively short time, and by 1958 nearly every passenger car assembled in Japan was of domestic design and manufacture.

The years 1960–75 constituted a unique period for the Japanese economy as a whole and for the automobile industry in particular. During this period of rapid expansion and growth, Japan evolved into a major world economic power. The Japanese automakers were encouraged by and responded to the growing domestic automobile market. Their primary objective, at least initially, was to secure a position in the Japanese market, which in turn would support the necessary scale of operation essential to their establishment as viable firms. All of the manufacturers shared the objective of upgrading the technical quality of the product, while continuing growth in sales and achieving unit-cost reductions through expanded capacity and improved efficiency. Only later in the period was expansion of export markets an important concern of the automobile manufacturers.

A mass market for passenger cars was quickly becoming a reality after 1965, in large part due to persistent guidance and regulation by the Japanese government. The government's involvement included the design of a tax structure that favored smaller-sized cars, an increase in highway construction budgets, and strict enforcement of biennial automobile inspection. The last measure had the effect of encouraging car owners to purchase a new car every four years because each inspection cost an owner as much as $300 to bring a car's performance up to standard.

Despite the fact that the government never succeeded in its principal objective of significantly reducing the number of producers in the industry, it made several essential contributions to the industry's development through the late 1960's. MITI first recognized the strategic role that an automobile industry could play in Japan's postwar economy and defended the industry's position against the opposing strategy of the Bank of Japan. It instituted the protectionist measures necessary for the infant industry's development and admitted into the country unassembled foreign cars in order to build a domestic technological base in automotive production. The timely extension of low-cost capital by the government played an important role in the strengthening of the industry. Finally, the government helped in developing the domestic market. Many of these government policies are similar to those directed toward the consumer electronics industry.

The government was instrumental in getting the industry started and in nurturing its development. It did not dominate or monopolize the producers, however. The initiative for development originated with the companies, and technological and economic success depended on their individual efforts alone. By 1960 the present-day competitive structure of the automobile industry in Japan had already emerged. As the Japanese automobile industry grew increasingly internationally competitive in the 1960s and 1970s, it also grew less receptive to government involvement in the industry. Thus as with the consumer electronics firms, the Japanese automobile firms have been concerned primarily with their own corporate interests and consider as secondary those interests that the Japanese government deems beneficial for the nation as a whole. Nevertheless the country as a whole has benefited from this situation in that the pursuit by the Japanese government and industry of their respective interests frequently have been mutually reinforcing. In the aftermath of the 1973 oil crisis, for example, the Japanese government was extremely concerned with foreign-exchange generation and reduction of oil imports at a time when Japanese automakers were gearing up for their intensive sustained assault on export markets and developing more-fuel-efficient automobiles.

CORPORATE STRATEGIES

As with the consumer electronics industry, the central corporate strategy guiding the Japanese automobile industry is based on a commitment to expand production volumes. From this commitment flow several other strategies that also greatly enhance the Japanese industry's international competitiveness. Company policies for increasing R&D and production upgrading through redesigning, reengineering, and automation have an intrinsic value, and their benefits are compounded when coupled with expansion of production volumes in an industry where scale economies are critical for success. Additionally the respect that Japanese firms have earned as expert international marketing organizations stems from their need to secure export markets for increased production volumes. Finally, the Japanese automobile industry (like the consumer electronics industry) has developed a form of vertical integration both internally and with its supply industries that is highly responsive to the exigencies of production volume expansions.

VOLUME PRODUCTION AND THE TECHNOLOGY FACTOR

The cardinal principle of the Japanese automobile industry has been to increase volume as rapidly as possible as a means of decreasing unit costs. Additionally the Japanese, in contrast to most American companies, consistently apply the so-called learning-curve management principle. Most U.S. firms therefore operate on a much flatter curve than do the Japanese with regard to rate of increase of output and derived efficiencies from learning and unit-cost decreases. As a result, the manufacturing cost of Nissan, Toyota, and Honda, for example, are estimated as being 40 to 50 percent lower than those of European or American firms.

Individual automakers have adopted various means for achieving scale economies while preserving the appearances of specialization and customizing. Nissan's triplet car system seeks thorough production rationalization using common auto parts and common production facilities to a degree unmatched by U.S. competitors. "Triplets" refers to three new model changes introduced to the market by Nissan between May and August 1977. These three car models are equipped with the same engines and chassis, and their bodies are designed along the same basic lines. A large number of common parts are installed in the three models, yet the use of different exterior part, such as front grills or bumpers, on each model gives them a different appearance.

Efforts to achieve economies of scale are also evident in production processes adoted by the Japanese automakers. One process that has been instituted in many plants is the simultaneous production of different model cars. The assembly line, consisting of as many lines as there are models being produced, is provided with necessary parts in conformity with the moving speed and direction of the lines, through computer operations. The timing of the supply and application of the parts to bodies is organized by the computer. While various kinds of cars are assembled simultaneously, the same parts are often applied to different model cars.

The Japanese automobile industry's ability to design and engineer industrial products and production systems and effectively manage them at successive stages of market growth has been essential to its successful production strategy. As wages have risen (they are still lower than comparable wages in the United States or Europe), Japan has maintained its competitiveness in world markets through continuing rationalization and modernization of its industrial plants and production methods, progressively improving its cost-effectiveness through constant value engineering of components and parts and improvement of overall product design. Of all Japanese industries, these capabilities have perhaps best been demonstrated by the automobile industry.

Japanese automobile companies have made remarkable achievements in designing and engineering production processes to improve production rationalization. Mitsubishi's plant in Okazaki, built in 1978, illustrates these efforts. The plant, which produces two different passenger car models, was structured with a view toward increasing automation, rationalization, quality improvement, and resources and energy savings. According to Mitsubishi, the plant has forty-seven robotized units (produced by Mitsubishi Heavy Industries) for the welding of car bodies and eight automatic painting machines; the plant is 75 percent automated and employs only 1,250 workers. The plant layout is designed to rationalize material flow from the press line right through the assembly line. Furthermore it is equipped with ten computers for easy model changeover and additions and for speedy and accurate inspection checkup.

The key to the Japanese automobile firms' generally successful efforts to increase production volumes through technological upgrading has lain in their willingness to make the necessary capital expenditures. Toyota alone has a $2 billion reserve fund for the upgrading of production technology. Nissan currently is investing $229 million in construction work alone for a new product line and technical development center. A simple ratio illustrates how much more committed the Japanese automobile firms are to make the requisite capital outlays for advanced production processes: in 1968, Toyota's plants housed about $16,000 worth of equipment for each plant employee, while General Motor's plants averaged $11,900 in equipment per plant employee; by 1978, it has been estimated that Toyota's ratio more than doubled to $50,800 in equipment per worker, while General Motors's 1978 ratio actually decreased a bit from the 1968 level.

The U.S. automobile industry recently has made a substantial effort to make the necessary capital commitment to reengineer automotive products, but only after foreign (mostly Japanese) imports had captured over 21 percent of the U.S. market. Chrysler in particular, and to a lesser extent Ford, are indicative of reactions that were too long delayed and responses that may still be inadequate in stemming the growing tide of Japanese imports. The movement of production facilities for major components to Mexico and Brazil is reminiscent of the U.S. consumer electronics industry's efforts to achieve cost reductions by moving to low-wage countries rather than by automating and robotizing facilities to meet the foreign competition. (Part of the reason for establishing production for export in Mexico and Brazil undoubtedly has been pressures of the governments in these countries to do so or face low market shares. But the adverse effects on U.S.-based technological parties have nonetheless followed.)

The Chrysler situation is symptomatic of the difficulties that U.S. industry in general is having in technological adjustment to economic change. A similar situation arose in the case of Toyo Kogyo, Japan's third largest automobile manufacturer, producing the Mazda car. After the 1973 oil embargo and soaring gasoline prices, Mazda sales declined rapidly. Although the car was powered by the innovative rotary engine, it was also relatively fuel inefficient. By 1975 the company faced bankruptcy, which would have put 100,000 Toyo Kogyo employees out of work, as well as countless suppliers. At this stage, the Japanese government did nothing more than encourage private-sector rescue attempts; the Japanese banking community serves as the protector of Japanese industry much more than does the government. In this case, Toyo Kogyo's main bank, Sumitomo, took the initiative in making the auto firm more competitive. Aside from making some shifts in management, slashing dividends, and reducing the work force by offering early retirement bonuses, Sumitomo helped raise a $1 billion syndicated loan. The money was targeted for plant modernization and redesigning and reengineering the Mazda. Within two years, Toyo Kogyo had put a fuel-efficient subcompact in the Japanese and U.S. markets, which sold briskly. By 1978 the company perfected a fuel-efficient rotary engine, and sales of its rotary engine sport coupe took off dramatically. In 1979, a healthy Toyo Kogyo realized a record profit of $30 million, despite the loan repayment burden to Sumitomo.[1]

In regard to the Chrysler situation, two facets of Toyo Kogyo's recovery stand out. First, the Japanese government may provide strong protection for an infant industry, but once several companies in the industry have established themselves in the domestic market, intense competition is the rule. Uncompetitive firms are not assisted by the government, which is more concerned with the overall international competition of the industry rather than the domestic competitiveness of individual firms. Second, Toyo Kogyo realized, as all other Japanese firms do, that it could not rely on a government bailout but had to take the necessary long-range steps, including capital outlays, to regain its competitiveness. The upgrading of product and process technology was regarded as the key to a restoration of the firm's health.

The corporate structure of several Japanese automakers has also contributed to the continued strengthening of their manufacturing operations. In these firms the manufacturing, designing, and engineering functions are kept separate from the marketing, sales, and distribution functions by means of separate companies responsible for these two sets of functions. Toyota Motor Company, for example, is engaged in designing, engineering, and producing automobiles, which Toyota Sales Company then markets; the latter determines market needs, changes, and size, and the former translates these data into actual products. Outside of this information exchange between the manufacturing and marketing groups, involvement by one group in the operations of the other is kept to a minimum, thus allowing each to pursue its functions more efficiently. In contrast, U.S. auto firms' marketing and production operations are much more closely linked, to the point that they disrupt each other's activities.

EXPORT STRATEGY

In order to achieve and maintain their high production volumes, Japanese automakers must look beyond the domestic market to absorb their output. In contrast to U.S. automobile firms, the Japanese industry does not place great weight on projections of world demand in establishing production capacity targets; Japanese automakers add capacity first and then search for overseas markets to absorb what the domestic market cannot. In fact, it has only been the existence of export markets that has permitted some of the late entrants, such as Honda, to achieve sufficient economies of scale in automobile production. (Honda exports 75 percent of its output.) Due to the difficulties of increasing penetration of the domestic market, Honda was forced to cultivate export markets if it was to achieve an efficient scale of production. In recent years export markets have also served to sustain the economies of scale built into Japanese automobile production when domestic demand has become stagnant. It is this phenomenon that underlies the observation that Japanese exports are stepped up at times of recession and are constricted during economic recovery or abnormally high-growth periods. Highly competitive pricing of exports also accompanies slow domestic growth periods.

Several principles that have guided the Japanese consumer electronics industry in its efforts to increase export are also found in the nation's auto industry. Established foreign markets, such as the United States, were entered through gaps at the bottom of the market (in this case smaller, cheaper cars). Although Japanese automobiles in foreign markets may initially enjoy price advantages (not infrequently due to foreign exchange rate levels), and this is critical in establishing market penetration, the Japanese manufacturers gradually shift marketing emphasis to quality, performance, and service as a means of broadening market appeal. The Japanese automobile (and consumer electronics) firms also have invested heavily in consumer and market research in foreign markets in order to identify opportunity areas. And these firms have been assisted in this and distributing activities by the far-flung networks of Japanese trading companies.

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[1] See Yoshi Tsurumi, "How to Handle the Next Chrysler," Fortune, June 16, 1980, pp. 87-88.

Japanese automakers generally avoid or delay to the maximum other countries' protectionist measures arising from high levels of Japanese auto imports. The Japanese industry will produce offshore for a foreign market as a last resort—for example, if protectionist actions threaten to close a given export market. Japanese automobile manufacturing facilities in other countries have been characterized by low-technology operations; advanced automation and production of high-technology components are retained at home.

The success of Japanese cars and light trucks in U.S. and Western European markets has resulted in restrictions of Japanese imports, and other protectionist reactions are imminent. Japanese firms have reacted with plans to invest in production facilities to continue to maintain their position in these markets, just as they did in the case of color television receivers. Nissan is now assemblying trucks in Tennessee, and Honda has started an assembly operation in the United States. Nissan is negotiating a joint venture in the United Kindgom, which it intends to use as a major entry point to the European Community market. Nissan also now has joint ventures in Italy (with Alpha Romeo) and in Spain (with Motor Iberica) and are negotiating a major joint venture with Volkswagen in Germany. Volkswagen and Nissan are working on a reciprocal arrangement under which Nissan will assemble and partially manufacture VWs in Japan for the Japanese markets and Volkswagen will assemble and partially manufacture Nissan products in its U.S. plant for the U.S. market.

VERTICAL INTERGRATION AND SUPPLIER INDUSTRIES

One of the most salient characteristics of the Japanese automobile industry is its high degree of vertical integration. Automobile companies in Japan have strived toward self-sufficiency in the forward and backward linkages of production due to two important features of the industry. First, the high fixed costs in plant and equipment needed for automobile manufacture dictate that economies of scale are extremely important at every stage of operation. Second, in Japan during the 1930's and 1940's, firms in several industries recognized that the inadequancies of Japan's basic industries could be overcome only by producing basic materials and major components internally. For example, the Aichi Steel Works, Ltd., has its origins in the steel works department that was established in 1935 by the Toyoda Automatic Loom Works. In 1940 that department was separated and made an independent company called the Toyoda Steel Works, Ltd., the direct predecessor of Aichi Steel Works. The role of both Toyoda and Aichi Steel Works has been to keep Toyota adequately supplied with special steels, a vital basic material, recognized as holding the key to mass production.

The extent of vertical integration in Japanese industry must be viewed in relation to supplier industries. The benefits of vertical integration in Japan are derived in great part through unconventional structural patterns or relationships with supplier industries, illustrated by Toyota Motor Company's production system. The low level of internal parts production done by Toyota itself is strongly supplemented by a tight supplier-purchaser relationship. The Toyota Motor group embraces companies in different industries. Essentially controlled by the Toyoda family, the group is roughly divided into two major subgroups. The first subgroup is composed of twelve corporations closely related to the Toyoda family. The second subgroup comprises other companies linked with the group through business transactions.

The twleve companies belonging in the first subgroup are directly controlled by the Toyota Motor Company. A variety of industries are represented in this group, such as specialty steel, textile, machine tools, and trading (in nonautomobile products). Belonging to the second subgroup are mostly local companies operating in the Tokai region surrounding Nagoya and closely connected with the automobile operations of Toyota. Toyota directly or indirectly provides these firms with funds and production processes. The companies principally serve as Toyota's suppliers. Toyota relies on over 280 subcontractors, who in turn rely on an even larger number of smaller firms; in all, Toyota may use the services of over 25,000 Japanese firms.

In a number of these companies, Toyota exercises control through stock onwership, which usually amounts to a 20 to 30 percent equity position. It is often through these subsidiary relationships that the company achieves the kind of vertical intergration typical of large American and European automakers. In general, Nissan's production system and parts procurement practices are quite similar to those of Toyota, except that it typically maintain tighter control, owning as much as 50 percent of the parts companies' stock. Even in the absence of stock ownership, there exists within the Japanese enterprise system a keen awareness of the strong interdependencies among the different companies developed through historical, family, or structural ties.

The vertically integrated relationship Japanese automakers maintain with parts suppliers has greatly facilitated efforts to expand capacity or increase efficiency to reduce costs or improve technical quality of products or production methods. The Kanban (on-time delivery) system, which is used by several Japanese automakers, is a case in point. In this system supplier firms deliver shipments of parts and components to automakers' production plants virtually hours before they will go on the assembly line. In this way much less investment for parts inventory is needed by the automobile firms, and thus operating costs are reduced. Additionally changes in parts specifications by automakers do not cause the obsolescence of a big inventory of parts. In cases where there is an equity interest, the automaker can exert direct influence on a parts suppliers' operations by placing employees in key management positions and by working with the affiliate's technical personnel. Additional control can be achieved through the placement of a principal stockholder on the board of the supplier enteprise.

SUMMARY

The Japanese challenge to the U.S. automobile industry is similar in several respects to that which overwhelmed U.S. consumer electronics. The intense competition fostered by the domestic auto market has served as a springboard for exporting efforts now central to the Japanes industry's stability and success. Although the government nurtured the early automobile manufacturers, it could not substantially influence the industry's structure. As the industry gained strength, the government found itself at odds with the leading firms and ultimately withdrew from direct involvement. Through expanded production volumes and product lines, technological upgrading, and extensive vertical integration with supplier firms, the major Japanese automakers have created the basis of an export strength that threatens the independent existence of their U.S. counterparts.

Chairman **Gibbons**. I thank you for your observations. Perhaps I thank you because my observations are so nearly similar to yours, and yet my observations, compared to yours, are really extremely casual.

Last year, when we returned from Japan, we reported that their banking system was unique, and it was something that we, as Americans, ought to look at. Their capital accumulation systems were great. There probably is something in their heritage, being a nation with small and limited natural resources, and constantly having to be aware of husbanding those resources and working together, or starvation—and Japan has faced starvation a number of times in this century—and that adversity pulls people together.

The fact that Japan is a very homogeneous society, compared to ours, and they have not been blessed or cursed with a tremendous amount of natural wealth that we have, their attitudes toward husbanding and making the best out of what they have are different than the average American's.

Mr. **Baranson**. Right.

Chairman **Gibbons**. There are things I see in their society that I admire and there are things I see in their society that I abhor. Essentially what they have done is take advantage of the common knowledge that is available to most reading-and-writing people on Earth and turned it to their own best interests.

Mr. **Baranson**. Right.

Chairman **Gibbons**. That is the way I read Japan. I don't find anything in there that is mysterious or so unique that it would mean we have to drop something and try something else.

I think it really is a cultural matter as far as the United States is concerned. We have been a big country, blessed with a tremendous market and lots of resources, and we have lived it up. That is the way I see it.

Now, I can't—I have tried for the life of me to understand what is wrong with the yen-dollar relationship. Obviously, there is something wrong with that system, but there seems to be no magic or hidden solution to it.

Have you looked at that end of the relationship?

Mr. **Baranson**. The yen-dollar relationship?

Chairman **Gibbons**. Yes.

Mr. **Baranson**. Yes. I think that the most important thing is that as a government, MITI, the Bank of Japan, those concerned with managing the economy, are much more tuned into, wired into, attuned to the needs and circumstances of industry, domestically and foreign.

And this is part of the maintaining of the favorable environment for industry. They are extremely conscious—the Government changed policies as industry matured from the infant to the mature stage. In the management of the yen, the purpose of maintaining it at an undervalued rate was precisely to give the Japanese industry an "in" into world markets.

The present aberration probably—of a depreciating yen versus the U.S. dollar—is largely traceable to differentials in interest rates.

Chairman **Gibbons**. That was probably possible more before we went to a floating currency than it is now.

Mr. **Baranson**. Yes.

Chairman **Gibbons**. Now, it would take massive amounts of wealth loss to control interest rates.

Mr. **Baranson**. You are quite right.

Chairman **Gibbons**. I don't know whether the Japanese could control them; I don't know whether we could control them if we intervened directly in the market, unless we are just willing to squander tremendous amounts of the Nation's wealth.

Mr. **Baranson**. The exchange position?

Chairman **Gibbons**. Yes.

Mr. **Baranson**. Yes. I agree. I think that is so

But again, the point is that not only is policy harmonized from the point of view of interest rates, foreign exchange position, and the availability of capital for innovation, but that that is harmonized between people who are making public policy and people who are involved in corporate planning in the business of actually adjusting industry to changing world markets and competitive conditions.

Now, it is that awareness, sensitivity of government to industry's outlook, needs, and circumstance that is much better managed in Japan than here.

Here, as you well know, Congressman, this business of being at odds with one another—of Government doing one thing, the Department of Defense doing one thing, and Treasury doing something else—and industry going its own way, is rampant.

As an example now, I know that some automotive industry, people have taken adverse position to the proposed local content law. It is very understandable, because, in the last 3 or 4 years, they have been investing heavily in component industries abroad, partly because of the difficulty encountered in trying to capitalize new plant and equipment here in the United States, and now with these component industries abroad, they depend heavily on the foreign component industry for cars assembled and sold here. They would be badly, adversely affected by the proposed local content law.

But, again, this is a case where back in the late seventies, industry and Government should have had some understanding of where the economy was going and what a common policy between Government and industry ought to be. That was not done. It has not been done to this day.

Government makes its decisions—and segments of Government, for that matter—based on the concerns and orientations that they have. There isn't enough of an effort to look at the larger role and larger perspective and see that we come to a policy that is good for the country, that industry can live with, that will not get us into the kind of economic difficulties we find ourselves today.

And the Japanese have done that as a mode of government-industry relationship; a mode of action and a mode of managing the economy. We have not. We have much more——

Chairman GIBBONS. Is there anything unique in their political and social system that encourages them to do that? The constitution they have was largely imposed upon them by us.

Mr. BARANSON. Congressman, I believe that; I think you, yourself, remarked that a good deal of what Japan has done and the way that it does it, is culturally related. That is undoubtedly true. There is no question but that a lot of their success is traceable to ethnic values to their drive and discipline, and to relationships based on Japanese culture.

But I think it is a mistake to carry that too far. We shouldn't believe—I believe that at least 50 percent or more of success or failure in the economic sphere has to do with policy, corporate policy, economic, public policy, and the perceptions, the policies and implementation patterns we develop.

Within our culture we have to find ways leading toward a national consensus and do things more effectively, but to say that their—that the cultural difference is such that we really can't emulate or countervail, I think is probably wrong in the sense that we have to define what part of this is policy, and to what extent can we change policy.

I think it has to do with management and how management looks at itself.

Chairman GIBBONS. Is it the way management is trained? I have been hammering on the management theme because that is one of the themes I learned when I was there last year.

Mr. BARANSON. Again, a lot of the positions that American industry has taken—and the automotive industry—a lot of what was done was too little, too late. By the time the industry woke up in the late seventies and tried to recapitalize and redesign and re-engineer, the bill was up to $80 billion or more and the industry was already threatened in its profit position and did not have the funds to spend that amount.

Now, analysis done on this by the people at Harvard Business School and elsewhere shows that this difficulty was due to mismanagement. Detroit's attitudes were based on complacency and arrogance, and I use those words very advisedly; it means the industry locked itself into inflexible manufacturing systems on the basis that no industry could really touch them in the world, and that the thing to do was to go for high volume versus capital-intensive inflexible manufacturing.

The Japanese already, in the midseventies, saw this, and they began robotizing and introducing flexible manufacturing systems that meant that as consumer demands shifted to energy-efficient cars, they would have something which could much more flexibly respond to world changes.

American industry remained complacent and inflexible, and we were locked into investment costs that made it extremely difficult for Detroit to retool.

Now, how much of this is traceable to cultural values and American lifestyle. I am sure there is an element of that, but I think again we should not go too far down that path.

We should decide what was right and what was wrong in the past, and we need to reconsider and change some of our thinking and ways of looking at things.

Again, there were serious management mistakes in this area. Too often, management's recourse in recent times has been to spend money on politicizing that we are all right and things are going to be better, rather than getting down to the hard business of recognizing things that were wrong and changing them.

I think it is hard for us because in the past we have been so successful and tough foreign competition rarely touched us anywhere in the world. But the hard times are coming now in terms of world conditions and world competition, and the important thing is to recognize where things were wrong, where management errors were made, and to try to do better from here on out.

Chairman GIBBONS. You know, I hate to keep going back to personal experiences but I think we learn from personal experiences. Last year in Japan one of the factories we visited was a Toyota factory. When we went to Toyota City we were met by Mr. and Mrs. Toyota. They walked through the factory with us, explained to us, told us what they were doing, proudly pointed out where they thought they were better than the U.S. concerns. I have been through other automobile factories and really the factory wasn't that different except it was more automated than the assembly lines that I have seen here. People doing the final assembly job, other than their physical differences, looked like the workers that were doing the final assembly work here.

Yet, I never get constitutents coming to me to tell horror stories about their Toyota. They come to me all the time telling me horror stories about their American products. But it was obvious. Not only was it their Mr. Toyota who was the nephew of the founder of Toyota, but also the son of Toyota was the factory manager there, and he looked to be about the same age as his cousin. I have never really figured out why he wasn't running the shop that his cousin was. They worked out something in the family—it was a family-run corporation. People obviously were very proud of their jobs and their relationship was good.

We went on to another factory the next day and visited a Sumitomo plant, a big electrical concern there, and the heads of Sumitomo said, that they owe the Americans a lot. And I expected him to say something about the physical or financial resources. He said, no, no, when they set up their government after World War II they solved our labor-management relationships. I said what do you mean?

He said, you know we used to have hostile labor-management relationships before World War II, but somehow after World War II, because of the imposition of a new constitution and new laws and new everything else, we don't have that hostile labor-management relationship any more. He went on to elaborate on that.

Did you ever look at that? Can you explain what happened there?

Mr. **BARANSON**. Mr. Chairman, the labor-management relationship in Japan reflects some of the deeper cultural factors you mentioned earlier. It also is based on some very practical and pragmatic labor policies. Let me just mention two.

One is the fact that 30 to 40 percent of wages that many of the companies are talking about are in the form of bonuses based on performance.

Chairman **GIBBONS**. Is that individual performance or company performance?

Mr. **BARANSON**. It is company.

Chairman **GIBBONS**. Company performance?

Mr. **BARANSON**. In which they have a stake. When the company wants to automate or put in robots, the laborers are interested in that because they know that company performance—and their spring and fall bonuses—will depend on how successful the company is and that automation is part of that.

The other factor concerns quality control circles.

These are not only part of Japanese culture, but, as you indicated, Congressman, they got it from us. The old quality control idea, the basic principles and methods came from us—but they have adopted it in a much more effective and thorough way.

The quality control circles are effective and working in Japan, the thing that you are talking about, the zero defect in the Toyota and other products, is based on the fact that they work there. Here in the United States lipservice is paid to the value of quality control circles. But it is merely a slogan; management doesn't believe in them, labor doesn't believe in them, and despite the ads that go on television they will never take in this country the way they have in Japan until we begin to change some attitudes and values about how important the performance and productivity of a company is to the individual worker.

I visited a steel plant a few months ago down in North Carolina. I was very interested because I saw in Fortune magazine that the firm was among the 10 top performers in 1981. I wondered how a steel company with all the trouble they are in does so well? It is a new corporation.

The president of the company ticked off two or three success factors which reflected Japanese management style. One of them was precisely the bonus system. Forty percent or more of the wages paid at that plant are in bonuses.

By the way, the average wage in those plants, despite the fact they are not unionized, is higher than the union wage in the steel industry.

Chairman GIBBONS. That is interesting.

Mr. BARANSON. Let me mention something else. You were talking about Toyota. Toyota in 1968—about the time when the volume of the automotive industry and the unit cost of Japanese cars were just beginning to cross with the United States—caught up with U.S. competitors in terms of unit costs of vehicles.

In 1968—the figures are in this chapter—Toyota averaged capital investment per worker close to $16,000. Believe it or not, General Motors was only $12,000.

By 1978, 10 years later, the ratio was about $50,000 for Toyota and it was under $12,000 for General Motors; GM's ratio had actually declined.

In the Japanese capital budgeting policy Japanese firms have a slogan of "destroy and build." They are constantly looking at the efficiency of their equipment, constantly robotizing, and automating.

The Japanese probably have eight times the installed robotization and flexible manufacturing systems than does the United States, and they are adding to their stock at a higher rate than in the United States. General Motors now is thinking about increasing its robots from 300 to 1,500, hopefully in the next 2 years, as part of catchup. Again, American industry is now playing catchup with the Japanese, who have always been playing the game of looking ahead and building ahead.

Chairman GIBBONS. That is what really concerns me. I have the feeling we are playing catchup. About the time we catch up we are going to find out we are 5 years behind again because from just my casual observations—and I tried not to be casual but I am not a trained observer of this process—it looked to me like they were already leaping ahead in just a steady development.

That really concerns me as an American.

Mr. BARANSON. Take the machine tool industry in this country; it is totally inadequate to the retooling needs of the country. When I was over in Japan just a month or so ago, there was an American company, one of the leading heavy equipment manufacturers, competing against a Japanese company now that is almost 90 to 95 percent robotized as compared to the American company, with only about 25 to 30 percent. It has decided it had to move to 85 percent robotization and flexible manufacturing systems within the next 2 years to survive against their leading competitor in Japan.

It has given up on the American tooling industry and is looking to Japan for the retooling and automated manufacturing equipment. They are trying to make a deal with a Japanese robotics company as General Motors did with Fujitsu-Fanuc to design and engineer the robots it needs for survival. Many American companies concerned with survival now are looking to Japan for retooling.

This is a very sad situation.

Chairman GIBBONS. Going through the Kawasaki plant where they were manufacturing industrial robots for use in the Toyota plant; I hear, you know, that the program is a part of the tool. They showed us robots there which didn't require programing, all you did was switch off the automatic part, put it on the learning cycle, take the head of the tool and guide it through the operation, and from there until the tool wore out that is all you had to do, oil it every now and then, maybe. But then they let us actually program one.

You know you didn't hire a programer, you just did it. You took the head of the tool and led it through the operation and it did that operation like that.

They told me that one of the policies in Japan was to replace every monotonous, hazardous, and repetitious job in the Japanese economy with a robot. That sounds like a good humanitarian program. You don't want people doing drudgery and hazardous and monotonous work when you can get somebody else to work for you for, you know, we work to live, not live to work.

Mr. BARANSON. Congressman, it is not that the Japanese——

Chairman GIBBONS. We work to live, not live to work.

Mr. BARANSON. It is not that Japanese management is that much more compassionate about the social needs of workers. They are concerned about productivity and motivation and they recognize this as part of that. But the fact is that they have robotized because they know that that is the way of the future—this is the third industrial revolution. They were aware of it 7 or 8 years ago and are already in full floodtide to move in that direction. We are just beginning to catch on.

Chairman GIBBONS. It is not that we do not have the technology, American-patented machines, it is just that we do not have the management that can apply it.

Mr. BARANSON. Interestingly enough, Unimation in 1968 developed and tried to commercialize their first prototypes; they were unable to get the venture capital in this country, and the reason they tied up with Kawasaki was because the Japanese economy provided the resources and the financing for Unimation to move ahead. In the process, the Japanese were able to get and commercialize the technology that was originally developed in this country.

To this today, we were talking about the programing and controls. We are still in the forefront in this area of CAD CAM, computer-aided design and manufacturing, the software, the programing. The California-based companies have some of the finest engineers in the field, and that is what the Japanese still want. This software is the last piece of their industrial program. The thing lacking in this country is the innovative thrust, the commercialization of technical opportunities and resources.

Chairman GIBBONS. Let us go back to Toyota again. In this huge factory that was running full blast, turning out the 1982 model cars, we walked into the steel delivery side. They were taking—there was one flatbed truck there—one roll of it. I thought, how can you run a factory with just that little bit of steel? There was not a lot of steel stacked up there. The steel went straight from the flatbed truck to the stamping presses and right on to painting without anybody intervening, really. The cutting, the stamping and welding and shaping, everything. And a remarkable display of automation.

I knew enough, I said, "Mr. Toyota, where do you keep all the inventory that you have to have to run this thing?"

He said, "I will take you to show you where it is."

He took me to a room that could not have been larger than this committee hearing room, and the place was about vacant. He said, "That is our inventory."

Mr. **Baranson**. The cost differential between United States and Japanese cars about a year ago was about $2,200 on a $7,000 vehicle; $700 of that was the inventorying inefficiency of American industry. Ford started a year and a half ago to try to copy the system the Japanese had. Inventory management is a very important element of overall efficiency and robotizing has three fundamental efficiencies built into it—saving on materials and space.

The other thing is quality. The new systems build in quality control the way the man-machine relationships could not do. The testing and assembly is built into these new systems. It is not just a matter of unit costs, it is a matter of the quality and the side effects that have added to this.

As I indicated, the Japanese saw all this, the Government made sure that the they had the resources and that the export environment was adequate, because the Japanese have to export in order to maintain high volumes of production.

Chairman **Gibbons**. Well, I thank you, and I want to yield to Mr. Bailey now.

Mr. **Bailey**. Thank you very much, Mr. Chairman.

Mr. Baranson, I want to thank you very much for the testimony. I think it is some of the best that we have. I think that there are a number of different things that you said that I have been trying to say through these hearings for 2 weeks, particularly I have been trying to criticize this idea that somehow this domestic content bill is just some interference with some naive and simplistic idea of free trade that supposedly exists around the world.

I want to criticize you and offer you the opportunity of course to rebut me. Your testimony is also, in my opinion, very honestly some of the most damaging I think that we have had, and I will tell you why, because of what you did not say. It is very clear to me that you know enough that you could have said more, sir, and I am going to be very critical of you on that score, and I want you to come back after me.

You started with an objective and reasonable statement, but you have blithely dismissed, in my opinion, a couple of concepts that play a very important role in this discussion. One of them was a word that you brought in called planning. And judging by the reaction that you are giving me now, you know the point that I am getting at. I think you glossed over that very, very quickly. I think that is core to the conflict between these two systems.

I also think that while you were correct in talking about the relationship between industry and Government, I think you are absolutely correct, the adversarial relationship between Government and industry and labor in this country, those things have also served some very crucial needs. For example, without them I do not know if we would have the kind of safety standards and some of those social policies. They are part of this discussion, too, what happens to people, and they also cannot be explained just by cultural effects.

I have done a study and we have consistently brought out in this discussion through a multitude of witnesses, those very few that have been brought before the subcommittee who were for the legislation, and that vast number who were against it, that wage rates and compensation are roughly comparable across the world, especially in the automotive area; in all the countries involved, including Japan, are the highest or among the highest paid wages, and there are good reasons for that. I have worked in those factories, I know personally there are darn good reasons for it, and there is a tendency to pay more because there is more required in terms of skill, particularly when it comes to repetitive tasks. It is a challenge, and there are a lot of folks running around the world getting paid $60,000 or $50,000 a year that would not take those jobs. I have been there. I know.

I would like to set those things aside. There is a danger, and it is an irony in terms of the questions and testimony that has been brought before this subcommittee, but there is a danger in responding to the Japanese experience perhaps the way that you said, and let me tell you why—and it may be just a disagreement between us in terms of opinion.

Let me borrow a term from our antitrust law, "tacit collusion." I do not think that is the best way to run a country. I think that it is an impossible way to develop an interdependent and an efficient world market system. Do you get my point—because it has that aspect of national planning and national goals that sets you in conflict when you set your priorities with the needs of other people around the world.

And I hope you understand what I am saying, because when you talk about that automobile industry, Mr. Baranson, you know, you very quickly glossed over the fact that well, for a number of years they protected it, but then it reached a world competitive stage and they backed away from that. Well, sure. I guess so, once it is not threatened anymore. But you know, just like with the currency arguments now, once you are strong and once you are healthy and in a good state, I guess you can back away from the protectionist status.

I am the first one to admit that American domestic policy is partly responsible for many of these difficulties. I want to compliment you on one thing. It is not correct to say that we have not learned from this competition. Our labor comes here, Douglas Fraser said that, we have learned. It was one of the most honest statements we have ever had. On the industry side the same kind of honesty, and I think both sides should be complimented for that reason. They would support you in some of the things that you said about waking up and being aware of some of the competition problems.

I share that view. I think the most foolish thing we could do is not recognize the fact that we have things to learn and adjustments to make. But I fear that we will never do that correctly unless we get a proper perspective on what this country is about and what our international goals and objectives are going to be and what Japan's are going to be, because we cannot develop a world of competition, countries with competing industrial policies fighting against each other.

You injected in response to the chairman's question some information about machine tools. I was delighted when you did that, and I am glad to see that you are smiling, because you have got a lot of questions to answer in that area. And you know what I am talking about, do you not? Are you familiar with that petition—I want to do everything I can to publicize and bring to the forefront in this country the Houdaille petition that was presented to the President for relief.

Mr. **Baranson**. I have not read it. I know of it.

Mr. **Bailey**. Please do, because a fellow with your expertise and knowledge and your sense of history, I think it will be valuable to you. I mean that sincerely. I hope that you read it.

Mr. **Baranson**. I do not think I can afford the $1,200 a copy that it is selling for.

Mr. **Bailey**. Come to my office and then get access to a Xerox machine. I would like to give you a copy, but I cannot do that—you need to study that thing. I will make it available to you for study, because I have it. There is no better example—if you are talking about Government protection, clear, outright, total, complete, utter, absolute—and my thesaurus is not handy or I would go on, Government identification of a particular industry, protection of that industry with a multitude of policies and a deliberate targeting of a market in another country to destroy it and put yourself in a position of control. And it has been remarkably successful.

Now, there also was an implication made, and I do not know whether you meant it or not, about foot-dragging by American labor or American management or somebody—you did not really point a distinct finger, and I could not figure out who you meant, but somehow an implication of some kind of drag on productivity improvements. We have had consistent testimony that that has not been the case. You feel that we found ourselves with a lethargic management. That may be true. I do not know. But sir, I can tell you this, they pretty much responded to what domestic policy had been for many years in this country in terms of exporting, everything from capital to technology abroad. They have pretty much followed the kind of technology-exporting practices that have been encouraged by Government policy in this country in everything from licensures to copyrights and even tax codes, which have encouraged the flow of technology abroad, and American business and management and American labor should not be blamed for that.

And last, I would say this and invite your comments. I think the country has suffered very much from an antieverything syndrome. I was in the service and out of the country for a good while, and I came back and the extent to which every single institution in this country was under attack, I do not know who is to blame for it, I do not know if it is because the broadcast media grew up and decided they were becoming policy-formers in a new Third World power or something, or because phony and demagogic politicians came to the fore and were saying the easy things and criticizing institutions that get the headlines—I do not know. But I know that every institution in the country, if it was making a profit it was bad, if it was work hard at your job, it was bad. If it was a politician, it was bad.

I support your comments about this adversarial thing in this country. You are right on target there. I really compliment you for bringing up that point, because that is an attitude problem in the United States that hopefully is going to change. That antisyndrome, I do not know what to do with it. But I think we are going to have to develop an industrial policy, quite frankly. Mr. Bergsten was here yesterday, and he agreed with me on this point.

In order to survive and particularly in order to protect our defense industrial base we are going to have to develop a competitive industrial policy. I think that has been our fault in this country. That gasoline shortage was the thing that killed us, in my opinion, because if I turn the pages on your arguments I could say the Japanese never decided to want to build a big car and come in here and sell a big car in the American market. I do not know if they were going to try to compete with Cadillacs and Buicks and Oldsmobiles and the larger Plymouths and Chevys. I do not know that. Maybe you can enlighten me.

I am sure I have not given you much food for thought. I think you need to comment on that planning thing. Because if we did that through the broad range of areas that the Japanese have, and made war on somebody else's economy almost in effect—I am not saying it is deliberate, I am not saying they are after us—I do not believe that kind of stuff—but if we did that kind of thing I think the world would go up in smoke. And this bill, incidentally, is a great attention-getter. At least we have all got to admit that.

Would you comment on some of the points that I raised?

Mr. **Baranson**. I will see what I can do, Congressman. The testimony I have given——

Mr. **Bailey**. Speak up a little bit, sir.

Mr. **Baranson**. The testimony I have given is based as I say on an effort to understand a situation, diagnose it, and to try to move in a prescriptive direction, what should we do about it. We have evidence in that chapter about the nature of Japanese Government action——

Mr. **Bailey**. I did not get a chance to read it. I just got it this morning. I am sorry, I apologize.

Mr. **Baranson**. Not at all, Congressman. You and I are in a similar situation. I was just asked 2 days ago to prepare remarks. As a matter of fact, I got up at 6:30 this morning to make notes that were reasonably coherent.

Mr. **Bailey**. I understand.

Mr. **Baranson**. And as I say, one can look at the same set of evidence about what has been the nature and course of Japanese Government policy in support of the automotive and other industries, and I am sure different people looking at similar evidence will come away with different impressions.

I have not read the Houdaille report, but I have been on the panel with the president of Houdaille a couple of months ago at the Chicago Foreign Relations Council, and he did spend 15 to 20 minutes highlighting the report, and we did have a panel discussion on it. What he called "tacit collusion" we, based on the evidence that we have, have called it "effective harmonization of Government and industry policy."

Mr. **Bailey**. I was trying to be kind to you and give you the benefit of the term "tacit collusion." In the Houdaille petition it is very, very clear that there is no tacit collusion. That is an adjective called overt, clear, plain and simple, a totally different situation.

Mr. **Baranson**. I must apologize for my—I do not have any legal training, and I am sure we are getting into legal terms of what the nature of collusion is. I know that the president of Houdaille did use the term "cartelization." He said that the Japanese industry was cartelized, and he did use the word "collusion." He said that the Japanese Government was in collusion with industry to cartelize.

Mr. **Bailey**. Yes, but let me for the benefit of the discussion—he was talking about cartelization, the division of the market in the United States for purposes of driving people out, something which if it happened internally here would so clearly subject the companies to an antitrust suit. They would not even attempt it in the first place. That is not in the interest of world trade, in my opinion. The other side is practice at home, to protectionism and the stealing of ideas, to the point where you actually encourage somebody to come in and license with you technology and invest in your country then copy that technology to readapt it and reuse it somewhere else.

Mr. **Baranson**. The Japanese have been very astute at this all along.

Mr. **Bailey**. Astute and what is legal and good free trade practice, you have to be careful. That is what I mean about blindly dismissing some of these things. They are causing conflicts and pressures.

Mr. **Baranson**. I agree. To the extent that the Japanese have crossed the line and engaged in illegal or criminal action, I do not question this at all. The book documents—there was a period in 1952 when the Government passed a law which precisely was looking at the technology acquisition problems of upgrading the industry, and it was designed to give the industry complete and advantageous access to foreign technology.

Mr. **Bailey**. We are talking about automobiles now?

Mr. **Baranson**. Yes.

Mr. **Bailey**. Not tooling.

Mr. **Baranson**. There is no question but that they have repetitively engaged, the Government has passed laws and issued administrative decrees to reinforce the competitive position, strength, and vitality of Japanese industry.

Mr. **Bailey**. What if we had conducted ourselves since the Second World War in this manner? The difficulty with America having a responsibility for being a world leader, not just in terms of world values, but certainly in terms of military responsibility for the free world—what if we had done those things? What if we lose the vehicle industry, the steel industry, what if we lose mining, what are we going to do?

Mr. **Baranson**. I could not share with you more deep concern about the viability of our industry. The question is whether protectionism of a mature industry will reinforce the strength and vitality of our industry.

Mr. **Bailey**. That is where I think we disagree on the advantages of a piece of legislation like this. I tried within my meager abilities to make an issue here of these broader concerns as to why this legislation is here, and I think this legislative vehicle represents what is the politically acceptable public perception of a policy choice that has wound its way through this system and found itself on the public stage.

It is not a good answer to all the policy choices and these planning difficulties, et cetera, that we have. I would say this, sir: It is going to make the Japanese, maybe, understand some of the feelings in this country that they are not simply a case of fear that anybody that feeds them a pabulum that it is OK to do business this way—this is my feeling.

I know we disagree there, but it is doing them a disservice and doing the world a disservice. Because to talk about this as protectionism is not a good idea and not a response to a challenge from overseas which has clearly been for many years that way, until you are in a competitive position. In this case you can say, look at me, I am free and open, that is not to deal realistically with the world's problems.

I would insult you if I said this bill should not be criticized. The labor and corporate leaders have been here and said the same thing. But when she is all said and done, there is going to be rethinking of what the word called free trade means, what industrial policy is, what competition between nations is, and hopefully out of it will come some real semblance of free trade, capital cost equalization, free trade equalization.

So today those things will happen and then there will be a thing called free trade and then if Japanese autoworkers or Japanese management can beat Americans, I will say they did it in the same football field. That is not the way it is now.

Mr. **Baranson**. The survival of this country may depend on our economic policy over the next 5 years. With another 2 or 3 years of walking away from the basic issue of revitalizing the thrust of our industry and making it more competitive, we may lose invaluable time, Congressman. It will be too late then.

Mr. **Bailey**. I agree with you. When the administration came to town and wrote a tax act that got everybody excited with their commitment to 3 years of personal tax cuts to encourage consumption at the expense of the savings and investment improvements that they were telling all their supporters they were trying to foster and their supporters bought it, we did the greatest disservice to this country in terms of that industrial policy that has been done in the past 10 years, if you want my opinion, for what it is worth.

Thank you.

Chairman **Gibbons**. Thank you, sir.

Our next witness is Mr. Sprinkel, Under Secretary of Treasury. Mr. Sprinkel, we are glad to have you here. Mr. Sprinkel, you may proceed as you wish.

STATEMENT OF BERYL W. SPRINKEL, UNDER SECRETARY FOR MONETARY AFFAIRS, U.S. TREASURY DEPARTMENT

Mr. SPRINKEL. Thank you, Mr. Chairman. I am pleased to appear before your subcommittee to discuss the relationship between the dollar and the Japanese yen. I would like to make a few general comments and then I would be very happy to try to answer your questions.

In recent months, there have been growing concerns that the Japanese yen is "undervalued"—that it's in some sense too cheap. In addition, it is often argued that the yen is maintained at an artificially low level by Japanese Government efforts deliberately to enhance the competitiveness of Japanese exports.

It is certainly true that the yen has depreciated significantly against the dollar in recent years, even though it remained relatively strong against most European currencies. This depreciation has increased the competitiveness of Japanese relative to American exports, and I don't underestimate the difficulties that can cause for Japan's American competitors, here and in other countries. But I would like to offer a few points to put the yen situation in perspective.

First, developments in the yen/dollar exchange rate are not unique. Since the dollar entered its most recent period of generalized strength in mid-1980, most major currencies have depreciated against the dollar, and the yen has not been the weakest. For example, the dollar has appreciated by 78 percent against the French franc, 46 percent against the German mark, 36 percent against the Swiss franc, and only 22 percent against the Japanese yen. On a trade-weighted average basis against all OECD currencies, the yen has been virtually unchanged on a net basis since mid-1980.

Second, while there are a number of factors—here and abroad—that have contributed to general dollar strength, there are also factors more specific to Japan that help to explain the yen's weakness against the dollar, particularly in recent months. While Japan has a large trade surplus with the United States, its overall external performance in 1982 has been much weaker than previously anticipated. Japan's current account surplus of $5.1 billion through August 1982—representing about $7½ billion at an annual rate—contrasts sharply with earlier private, Government, and international organization forecasts of a 1982 surplus in the range of $16 to $20 billion.

In the first half of 1982, the volume of Japanese exports declined by nearly 6 percent at an annual rate, reflecting slack international demand as well as Japanese export restraints in the face of mounting protectionist pressures overseas—pressures which may themselves add to expectations of yen weakness.

In addition, with a very high domestic savings rate, Japan tends to be a net exporter of capital to the rest of the world. This tendency has been reinforced by the attraction of higher real yields in overseas financial centers, direct investment opportunities abroad, and a generalized worldwide "safe haven" demand for dollars. The recent growth in capital outflows from Japan is also associated with liberalization of controls on external financial flows by the Japanese authorities.

Liberalization and internationalization of the Japanese financial system is an objective this administration has actively sought. It is important to us, to the world trading community and, we believe, to the Japanese people, that Japan open its entire economy, including its financial system, to foreign participation. In the financial area in particular, we have sought timely and unrestricted access for all foreigners to raise yen financing in Japan through the Japanese bond markets and commercial banking system.

Substantial progress has been made in the past few years. There has been considerable movement from administered interest rates toward market determined rates on Japanese money market instruments. The bulk of formal controls on inward and outward capital flows has been eliminated. In December 1980, Japan implemented an amended foreign exchange law which lifted restrictions on all foreign exchange transactions in principle, whereas previously all transactions had been prohibited in principle unless specifically approved.

This year, Japan has dropped administrative guidance concerning eligible borrowers of yen loans; the U.S. Export-Import Bank reached an agreement with the Japanese authorities providing for access to yen loans under Exim guarantee to finance U.S. exports; and several U.S. companies have floated bonds in Japan without being subjected to established Japanese standards for unsecured bond issues.

Inward and outward capital flows have grown rapidly, in part in response to these measures. In 1981, for example, Japanese residents' net long-term capital outflows totaled $22.8 billion, and net long-term foreign inflows $16.3 billion, as compared with annual averages of $4 and $2.3 billion respectively in 1974–76. Gross inflows and outflows on foreign non-resident transactions associated with Japanese stocks, bonds, and repurchase agreements amounted to $78 and $63 billion respectively in 1981, as compared with annual averages of $3.6 and $2.9 billion respectively in 1974–76. Net long-term capital outflows from Japan have amounted to more than $14 billion in the first 8 months of 1982 alone.

Japan nonetheless continues to maintain certain domestic and external financial controls. We will continue to encourage Japan to pursue the path of freer markets, both in the trade area and in the financial area. I should note that one short-term consequence of greater foreign access to Japanese financial markets is downward pressure on the yen, and it is likely that this has been a factor in recent developments.

Both an increase in Japanese imports and greater foreign borrowings of yen increase the net supply of yen on the exchange markets. But in the longer run, such changes will result in a more efficient worldwide allocation of resources, both real and financial, and permit a freer play of competitive market forces. With continued U.S. success in reducing inflation, I have no doubts about U.S. ability to compete effectively in an open market situation—a level playing field—and that is what we are pressing with Japan.

Third, I want to stress that we have looked at the situation very closely and found no evidence to support charges that the Japanese Government is manipulating markets to weaken the yen. The Japanese financial authorities have assured us repeatedly that the

Japanese Government would like to see the yen strengthen. I have no reason to doubt these assurances. They feel that the yen's weakness contributes to inflationary pressures.

They would like to stimulate domestic demand in order to spur domestic economic growth, but are afraid that might weaken the yen further. They have tried to raise short-term interest rates—contrary to their domestic objectives at a time of very slack domestic loan demand—in an effort to strengthen the yen. And they have intervened in the exchange markets, at times very vigorously, in an effort to support the yen exchange rate. So we have heard the assertions that Japan is manipulating the rate. We are prepared to look at any evidence and, if any exists, we would pursue it vigorously with the Japanese authorities. But we haven't seen it.

Fourth, and finally, I am convinced that it is not possible to identify over or undervalued currencies at any particular point, despite the ease with which many observers seem to do so. Over the long term, I think it is true that exchange rate changes will reflect shifts in the relative purchasing power of currencies. The very sharp reduction in the U.S. inflation rate relative to Japan's over the course of this year has very likely been an important factor in the dollar's strength against the yen.

But, in addition, and especially in the shorter term, rates are—and must be—affected by myriad factors and would therefore generally differ from a purchasing power relationship. It is then very difficult to look at a particular currency and say it is undervalued or overvalued in any meaningful sense. In the final analysis, it is the interaction of buyers and sellers in the marketplace that determines currency values. There is no better guide.

It is important to recognize the sheer size of exchange markets. The Tokyo market handles roughly 3½ to 4 billion dollars' worth of transactions each day. Very rough estimates suggest that New York markets operate at around $40 to $50 billion per day, and that turnover in all world exchange markets is somewhere beyond $100 billion per day. This very size creates potential forces far exceeding the ability of governments to successfully control, direct, or manipulate—even if they knew the right rate or thought they did.

I would be pleased to respond to any of your questions.

Chairman GIBBONS. Mr. Sprinkel, starting with the caveat that I don't know all I really want to know about this subject, I would like to ask some questions. I assume the Treasury monitors these markets as closely as it is able to. Is that right?

Mr. SPRINKEL. Yes, sir. We get daily information on those markets.

Chairman GIBBONS. Do we have people actually working in those markets that could spot problems as they develop, or how do we do it? Do we really know that these currencies are not being manipulated?

Mr. SPRINKEL. We have looked at all the evidence that we could find. We have solicited information from the private sector. We have talked with the officials involved. We have a currency unit in Treasury that follows developments in exchange rates on a minute-by-minute basis. Fred Springborn, who heads it up, is here with me today. We also work very closely with the New York Federal Reserve, which has a much larger unit than we have, attempting to get as much information as we can.

At one time, these units were deeply involved in day-to-day transactions in the foreign exchange market. As you know, we no longer have a policy of massive or significant intervention. We intervene only in periods of what we believe to be unstable markets, which is infrequent. Therefore, when you say do we actually participate in that market, not much anymore. However, we have an ongoing, very careful and thorough following of developments and discussion with people in those markets, so I am convinced that we have a very good information system.

Chairman GIBBONS. One time this week, and I have forgotten what day it was, the yen was trading at about 269-plus to the dollar. Mr. Smith, the chief executive officer and chairman of the board of General Motors, stated, in response to a question that I asked him, that he thought that he would become very competitive with the Japanese if the yen were trading at about 180 to 200 to the dollar. Do you foresee anything in the market any time soon that we will be able to reach that kind of an exchange rate?

Mr. SPRINKEL. It is very difficult to make such forecasts.

Chairman GIBBONS. Let's look at the past history. How far does the swing go in the market?

Mr. SPRINKEL. It depends on a lot of factors. I think the most important one that has had the major bearing on the yen/dollar relation in the last year to be the sharp deceleration in our inflation rate vis-a-vis their inflation rate.

Remember since 1974 or 1975 they have had a very low inflation rate compared to the rest of the world, whereas ours was well in excess of it. They still have a low inflation and we have a much lower one. Our ability to keep inflation under control has certainly improved. I think perceptions as to investment possibilities following the supply-side tax cuts that have occurred and will occur have improved the odds toward the dollar.

Furthermore, any uncertainty, wherever it may be in the world, typically leads to some money moving into the dollar, not into the yen. So I could conceive of such a strengthening in the yen, but the immediate factors that might bring it about are less than obvious to me. We do expect as our recovery gets underway that we will be moving from a modest surplus on current account to a modest deficit.

Nothing else changing, that would argue that maybe the dollar would come off somewhat. We know that we have a significant trade deficit now although not as large as previously, and as we move into recovery, I would expect that trade deficit to widen. Again other things being equal, that might tend to weaken the dollar, but I personally am convinced that the most important factor, "*x*" uncertainties in various parts of the world or changes in government, is really the price stability in this country versus Japan.

I was in Japan in 1974 when they had enormous inflation, 25 or 30 percent, well above ours, but since that time they have done a good job of getting their inflation and keeping it down. So I find it very difficult to expect that the dollar is likely to weaken significantly vis-a-vis the yen or other major currencies.

Chairman GIBBONS. I don't know whether to cheer or to cry.

Mr. SPRINKEL. Well, from an export point of view I presume we can cry somewhat.

Chairman GIBBONS. I believe we only trade because it improves our standard of living and our economy.

Mr. SPRINKEL. Yes, sir.

Chairman GIBBONS. I have said, and almost worn the phrase out, we trade to live, not live to trade. And we only trade because it is in our self-interest, not from any theological beliefs that we have about this subject.

Mr. SPRINKEL. Yes, sir.

Chairman GIBBONS. But as I understand you, you are saying the balance of merchandise trade will probably get worse?

Mr. SPRINKEL. Yes, sir.

Chairman GIBBONS. And that will mainly be because, as I understand it, you feel that the dollar will not weaken?

Mr. SPRINKEL. Why we expect it to get worse is on both sides of the equation—that is, the strong dollar does act as a deterrent to exports. We can't ignore that. And it works with a lag and the dollar has been strengthening since mid-1980 much of the time. In addition, our imports are very sensitive to changes in our domestic income, and as income rises we would expect imports to pick up more than would occur on the export side, even assuming we get strength and economic activity abroad.

Chairman GIBBONS. What will this do to our current account?

Mr. SPRINKEL. We are expecting it to move from a modest surplus of a few billion dollars, which is where it has been running the first half of this year, into a modest deficit, but not a sharp deficit.

Chairman GIBBONS. I asked one of your predecessors years ago this same question and he had a tough time answering it. He is now the chairman of the Federal Reserve. Is the fact that we are running a surplus or a deficit in the current accounts good or bad? Maybe that is just too broad a question.

Mr. SPRINKEL. Well, the conditions that would bring about a sharp deficit would probably reflect deteriorating inflation expectations in the United States, among other things. Therefore, a sharp movement, persistent movement toward a current account deficit would reflect more fundamental factors, some of which would probably be adverse. But whether it is slightly surplus, slightly deficit, I don't think is a major concern.

Chairman GIBBONS. Could a country such as Japan interfere in the market to an extent that would not be detectable by you?

Mr. SPRINKEL. We get frequent information on intervention activity in Japan both direct and indirect, and there is no evidence that I can find, and I have looked very hard, because I am sensitive to the concerns of our exports. There is no evidence that they are leaning toward a direction that would weaken the yen. In fact, the opposite; the intervention has been in terms of strengthening the yen, and sometimes of significant magnitude.

Now, we try to get other sources of information to see if we are getting the correct numbers, and I think we are. I am perfectly willing to look at contrary evidence, and I have invited many businessmen to give me that evidence and we will look at it very vigorously, but I can't up to now find it.

Chairman **Gibbons**. Could I characterize your statement by saying that you are generally satisfied with the technical operation of the marketplace as far as currencies are concerned?

Mr. **Sprinkel**. Yes, sir. It is a very large market.

Chairman **Gibbons**. I didn't realize it was running $100 billion a day.

Mr. **Sprinkel**. That includes not just yen. That includes all the exchanges, most of them dollars vis-a-vis some currency.

Chairman **Gibbons**. Our exchange stabilization fund wouldn't go that far in that market, would it, 15 or 20 minutes, it looks like.

Mr. **Sprinkel**. You can get out of business in a hurry. That is one of the reasons we are not inclined to risk taxpayer money to tilt with windmills.

Chairman **Gibbons**. Gambling on the market.

Mr. **Sprinkel**. Yes, sir. Even the intervention that we have done is very difficult to detect. Much more fundamental is the kinds of policies being pursued in our country vis-a-vis other nations.

Chairman **Gibbons**. I assume you are in constant contact or at least in liaison with the International Monetary Fund?

Mr. **Sprinkel**. Yes, sir.

Chairman **Gibbons**. Is there anything in the wind about reform of this marketplace by the International Monetary Fund?

Mr. **Sprinkel**. Reform of the marketplace?

Chairman **Gibbons**. Well, generally, to the extent there is a boss in the marketplace, to the extent that there is any kind of international supervision of it, I guess they come close to being an international body that would have some kind of impact. Are they happy with the marketplace?

Mr. **Sprinkel**. Are you speaking of the dollar versus the yen?

Chairman **Gibbons**. The operation of the marketplace, the technical operation of the marketplace.

Mr. **Sprinkel**. I think they are happy. I have heard no statements to the contrary. I know that just as we submit ourselves to oversight review by the IMF, so do other major nations, and they try to encourage nations to keep an open market. Those countries that get into difficulties in balance of payments frequently put on exchange controls and almost always a condition of the IMF loan, among others, is to move back to a unified exchange rate that is market related.

They reviewed the Japanese Government I believe last February and issued a report. There was no statement nor hint of statement in that report that they were manipulating markets. So I think the IMF concern at the moment is not so much with reform of the marketplace as it is with concern that they have adequate resources to continue to do their ongoing job, which is a very important one and a job that we support very firmly, plus resources to handle any extreme threat that might occur to the international monetary system.

I am not aware of any dissatisfaction with the functioning of the marketplace in general.

Chairman **Gibbons**. I don't know whether we will call a representative of the Federal Reserve, but you mentioned that you worked with the Open Market Committee of the Federal Reserve in this market operation. Do you know whether or not they are satisfied with the operation of the marketplace?

Mr. SPRINKEL. I have heard of no expressions of concern from any of them since I have been here.

I should add one footnote to my prior statement concerning the IMF's attitude. I think they are pleased with the technical proficiency of the market.

What they and others, including myself, are concerned about is the extreme variability that occurs from time to time in exchange markets, and as you know, there is major effort to try to get a better convergence of policies between at least the major countries of the world, and hopefully others as well.

And one of the pluses in my judgment that came out of the Versailles summit was an agreement among the seven nations represented that there be an ongoing exercise between the IMF and the countries making up the SDR, that is, the large five countries, for a comparative analysis of policies for the purpose of getting closer surveillance. So they are working hard on that. We had the first meeting at Toronto and there are additional ones scheduled, so if we can reduce the volatility in exchange rates, we all win.

None of us like exchange market volatility. The question is, can you do it better by intervention or can you do it by getting convergence of policies toward lower inflation and higher economic growth, and their thrust is on the latter rather than the former.

Chairman GIBBONS. Yesterday we had a witness who had formerly been with the Treasury, and he had made some statements the day before to the National Press Club about the problems with the yen-dollar exchange rate and the dollar valuation. I am talking now about Mr. Bergsten.

Mr. SPRINKEL. Yes, sir.

Chairman GIBBONS. Have you had an opportunity to look at his remarks or——

Mr. SPRINKEL. No, sir, I have not. I know Fred quite well.

Chairman GIBBONS. Mr. Bergsten seemed to believe that the dollar—and I don't have his testimony right before me. He seemed to believe that the dollar was overvalued by about 20 percent and that he thought that the dollar was headed for trouble, meaning, as I understood it, that there could be a rather substantial devaluation. I asked him whether it was going to be a soft landing or a crash landing, and we had a little trouble with those semantics, but I think it would be accurate to say it wasn't going to be a gentle landing. Would you kind of comment on that.

Mr. SPRINKEL. Well, I find it puzzling that some people can so readily conclude that the dollar is either substantially overvalued or undervalued. I think it depends on a lot of factors, none of which are crystal-clear at the moment. If we were to move back—I certainly hope we don't—into a set of policies that leads to sharp acceleration in inflation vis-a-vis major trading partners, there is no doubt the dollar would go down very substantially. I don't think we are going to do that. I don't see pressure from either party to move strongly in that direction.

We just went through a very unfortunate inflationary experience, and not all those problems have been solved yet.

Assuming we hold onto policies that promote growth and reasonable price stability, he will have to convince me that it is clear that the dollar is overvalued.

I would not be surprised to see it move off modestly, but to argue it is going to drop 20 percent because it is overvalued, is contrary to evidence I see, and people that really believe they can get rich in a hurry if you don't work for the Government.

Chairman GIBBONS. To be fair, I am not sure he said it would change 20 percent, but he felt it was overvalued by 20 percent, and I think he was as much mystified as the rest of us about the apparent overvaluation.

Mr. SPRINKEL. Many argued—and Fred, I believe, made this argument; I am sure many others did—that it is the high interest rates in the United States, or if not the high interest rates, it is the rates vis-a-vis interest rates abroad that kept, for example, the Japanese yen undervalued and the dollar overvalued.

We have had an enormous decline in interest rates with little change in interest rates in Japan.

The spread has narrowed 450 basis points, and during that downward adjustment in interest rates here, the yen went down 4 percent; that is, the dollar went up 4 percent. I do not believe—did not believe previously—that levels of interest rates or even interest rate spreads, are consistently related to the exchange rate.

Once in a while, they are, but frequently they are not. The most recent example was a period when they clearly were not. Much more fundamental than interest rates spreads, is expectations about inflation in one country vis-a-vis another, especially when there is a major change. We cannot repeat that experience. We came from 12 down to 5, or thereabouts, while they were hanging in at relatively low levels, and the spread is not very wide now.

So, we can't gain on them much further, because they are not going to go to negative inflation. I am certain of that. They might even come up to meet us. But most of that adjustment from my point of view on inflation expectations has occurred. Now, to the extent the public around the world does not believe we will keep that inflation at 5 percent; sure, it could make a difference, but my own view is that the odds are pretty good that we will hold at these levels and lower.

Chairman GIBBONS. You touched upon the point significantly in your testimony about the pressure to open up the Japanese markets.

Mr. SPRINKEL. Yes, sir.

Chairman GIBBONS. What is your appraisal of their market now? Does it still need opening? If so, how much? What would that impact be on the yen?

Mr. SPRINKEL. We have two bits of evidence that are relevant as to whether they eased up. One is changes in stated policy, but you have to be very careful in assuming that there is a followthrough in terms of statements. The more important thing is what has happened to capital flows following the stated changes, and both bits of evidence strongly suggest that they have eased a great deal.

I do not believe they are fully free markets. They are not as free as the United States. Each time we meet with our Japanese counterparts, we urge that they move further in that direction. They, as you know, some months ago, promised further liberalization, both on trade and capital accounts, and so far as I can tell, very little movement, in fact, has occurred since that promise.

Mr. Brock, the STR and others at Commerce, as well as in our own case, urged them to do so.

Now, suppose they were to move 100 percent to open capital markets—that is the point you asked—what would be the effect on the yen?

Almost certain in the short run it would result in a further weakening of the yen. The reason would be that it would enable perhaps more corporations to borrow in the market, although those restraints have been reduced a great deal. They would borrow in yen, convert to dollars, and this would put downward pressure on the yen.

Furthermore, if it were even easier for foreign, for Japanese residents to export capital abroad because of removal of restraints, this would put downward pressure on the yen.

Now, there is a possibility that long run, it might strengthen the yen, the reason being that to the extent they move toward markets as free as our own, many corporations, individuals, might look upon the yen, if they continue to keep their economic house in order, as a close substitute or closer substitute for the dollar. Therefore, they could demand yen, and this would mean that it would be perhaps stronger, but offsetting that is the outward movement of capital.

So, it is unclear to me even in the longer run that it might go up, but it is possible.

In the shorter run, it is almost certain it would weaken it further.

Chairman GIBBONS. Mr. Bailey?

Mr. BAILEY. Thank you very much, Mr. Chairman.

Mr. Sprinkel, I will tell you, you have given us excellent testimony.

Mr. SPRINKEL. Thank you, sir.

Mr. BAILEY. I sincerely wish I knew more about this area. You really enlightened me. Incidentally, when Mr. Bergsten was here yesterday, he said almost precisely what you did about the effect of easier access to Japanese loans in Japan in terms of the effect on weakening the yen.

So, apparently there is some consistency there, but there are some other inconsistencies that I would like to try——

Mr. SPRINKEL. I can believe each statement.

Mr. BAILEY. OK.

But we had testimony earlier in the week by the chairman of American Motors, and he looked at a broader picture. Apparently you feel there is too much control. At least, your statement indicates that.

Mr. SPRINKEL. Yes, sir.

Mr. BAILEY. And that the overall effect would be beneficial; however, albeit he did not address the issue directly as I remember, at least I don't think he tried to, and I am not sure we really asked him about the effect on the exchange rate, itself. But he seemed to indicate that in the broader picture some of the things that you alluded to about confidence and about long-term effects—this is my question—is there more to be gained than to be lost even integrating the exchange rate prediction that you made with that policy, and, if so, what advantages would there be?

Mr. SPRINKEL. Yes, I think there is something to be gained for our companies as well as for the Japanese society.

Mr. BAILEY. What?

Mr. SPRINKEL. Through further integration—first, you get a more rational allocation of resources around the world; you would not be impeded by direct controls. Even though they are not nearly as intense as they were, some of them still exist. Furthermore, I think there are some advantages to a nation such as the dollar advantage of having a world-recognized currency, where it would be more frequently used. The Japanese, I hasten to add, are not so certain of that. That is one of the reasons they have been reluctant to ease up. But there are some advantages. There are also some responsibilities.

So, each time we meet with them, we urge further easing, and progress has been made. We are not the whole way there yet.

Mr. BAILEY. Is there a possibility way deep down—there is a lack of confidence in the world in the way the Japanese, over all, do business? That there might be a feeling that there is a world out there in Europe and the United States, North America, South America, different places around the world, where people are getting angry? I have been told that.

Mr. SPRINKEL. There is some dissatisfaction with the high degree of competition. As you might suggest, it is very frustrating to efficient producers in the United States to be underbid with Japanese producers, but if you back up to how they run their affairs, overall economic affairs, they in recent years have done a rather good job.

Mr. BAILEY. The Japanese have?

Mr. SPRINKEL. Yes, sir. They have a very high savings rate. We are on the lower end; they are at the top, the highest of any developed nation, which means their capital accumulation domestically and export abroad has risen a great deal. They have maintained sensible monetary policies. They have maintained relatively low inflation rates. They have a problem on their fiscal side. Their deficit, as you probably know, fiscal deficit, as a percentage of GNP, is one of the largest in the world.

Mr. BAILEY. It is financed differently, though?

Mr. SPRINKEL. It is financed mostly with that massive savings that is generated in the economy, and there is still sufficient savings.

Mr. BAILEY. That is a little less inflationary, right?

Mr. SPRINKEL. Yes, sir. That is the reason they have been able to keep the inflation down. They kept their money supply under control.

Mr. BAILEY. On page 3, you say it is important to the world trading community, and we believe to the Japanese people—I happen to believe so deeply with this, I would like to have you go a little further—that Japan open its entire economy, including its financial system to foreign participation, which you say here.

Can you just expound a little on that?

Mr. Sprinkel. Historically, they have had severe restrictions on the ability of the American corporations. For example, to sell bonds or to finance in their markets. At one time——

Mr. Bailey. I am sorry. Did you say particularly American corporations?

Mr. Sprinkel. I was thinking of American, but anyone else. No, just not especially American; they would not let foreign bonds be issued in Japan. But we happen to be among the——

Mr. Bailey. We were probably more active.

Mr. Sprinkel. Yes, sir, we were—more active is the word. And those restrictions have been eased up substantially.

Mr. Bailey. Are you satisfied yet that they are far enough?

Mr. Sprinkel. No, they still have a ways to go. But we have had no complaints of late from American companies that wanted to sell bond issues in Japan and were denied the possibility.

So, I don't want to say there are no controls left, because I feel confident there are some.

But they are not nearly as severe as they were. Consequently, Americans can finance. Now, one of the reasons—incidentally, I point out the volume has been quite low.

Mr. Bailey. But that is really not due to their liberalization; that is probably due to general world conditions.

Mr. Sprinkel. I am not sure. Their interest rates are low. If there are no important controls you would think a lot of Americans would rush in there and get that cheap capital.

Mr. Bailey. Please comment more on that. I have raised that question.

Mr. Sprinkel. My guess as to the reason, certainly it is the arguments I have had from some companies, is that they are unwilling to take on this exchange risk.

Mr. Bailey. They are fearful; there is a lack of confidence?

Mr. Sprinkel. They are fearful, yes, that at some point in time it would be very expensive to retire those securities.

So, that when you issue a security in a foreign country, you have to pay off in that currency. If it becomes more expensive to acquire that currency at some future date, it will cost a lot more in dollars to retire the debt.

Mr. Bailey. What bearing would that have on the remarks you and Mr. Bergsten made concerning the availability of credit in Japan? Borrowing in Japan and being able to participate there. Would there be any relationship to this tendency to project, if that practice were liberalized or engaged in to a greater extent, a weakening of the yen?

Mr. Sprinkel. That is my guess. The effect would be——

Mr. Bailey. What you have given us is the reasoning for it, is that correct?

Mr. Sprinkel. Yes, sir, that is correct. If you borrow in yen and convert to dollars, most of the borrowing would not be for investment in Japan, although some of it might be, but the bulk of it would be for investment elsewhere.

So they would borrow in yen, offer the yen for dollars in the marketplace, and that depresses the yen.

Mr. Bailey. I am grateful to you for that. That is one of the major things I was after. It is good for us to have it on the record, because you really did more to explain at least for me the reasoning and it is very helpful.

I thank you.

Japan nevertheless maintains internal and external financial controls; that is on page 4 of your statement.

What is the relationship between the Bank of Japan and the Government vis-a-vis the relationship between our banking system and our Government? Is there any meaningful difference? The reason I ask, and the obvious question that follows, is, can or should the Japanese do some things governmentally, policywise? Could they do anything that would help?

Mr. SPRINKEL. You are speaking about the relation between the Government and the central bank in both countries. Is that correct?

Mr. BAILEY. Yes.

Mr. SPRINKEL. As you know, in our case we have a high degree of independence of our central bank, not independent of everything; it is responsible to the Congress; it is not responsible to the administration, although there are efforts on both sides to coordinate.

Mr. BAILEY. We have recognized there is a great advantage to that. All of us realize when people were screaming about placing controls on the Fed that we realized that if you sat down and thought for about 2½ seconds, you would realize that would be one of the worst things we could do.

Mr. SPRINKEL. Of course, there are other central banks, like the Swiss National Bank, the Bundesbank, that are also highly independent.

Now, you asked about the Japanese.

I have a distinct impression they are much less independent of their Government. They are very closely coordinated. They have an input surely. I meet frequently with the head of the central bank and head of the treasury. They seem to be not too different in points of view. So I think it is fair to say that there is more control of the central bank in Japan than in the other three I mentioned. But it is conventional for the other countries. In the United Kingdom, at least the line of authority moves from the Prime Minister directly down to the Bank of England.

That is true of most central banks. I think it is true of the Japanese central bank.

Mr. BAILEY. They are not doing anything out of the ordinary there?

Mr. SPRINKEL. No, I don't think so.

Mr. BAILEY. The reason I raise that point; I want you to know we have not had one witness before the subcommittee who has asserted that there is a deliberate manipulation by the government or the Bank of Japan of the exchange issues. No one has asserted that. The question has been asked constantly whether or not there is a manipulation issue here, and I don't know where that fear is from. I don't know who is saying it, but we have not had a witness, including corporate witnesses, say that.

I am interested in the external financial controls. What does that mean?

Maybe I missed something.

Mr. **Sprinkel**. There were some restraints on the ability of Japanese to invest abroad. Most of those——

Mr. **Bailey**. What were they, sir?

Mr. **Sprinkel**. Inability to convert yen into other currencies for the purpose of making investments abroad.

Most of those were eliminated at the end of 1980 such that those capital flows have increased a great deal.

There are still some remaining controls on certain investments within Japan and in certain industries. They have a list of industries affected.

Mr. **Bailey**. A list of industries?

Mr. **Sprinkel**. Yes, sir.

Mr. **Bailey**. What industries?

Mr. **Sprinkel**. I can give them to you.

Mr. **Bailey**. Would you?

Mr. **Sprinkel**. I remember some: leather, agriculture, and a few others.

Mr. **Bailey**. How does that operate? What do you mean controls of industries?

Mr. **Sprinkel**. Let me give you the list.

For even investment in certain sectors: mining, petroleum, leather, leather products, agriculture, forestry, and fishery.

Mr. **Bailey**. Mining?

Mr. **Sprinkel**. And 11 designated firms are still restricted. They have reserved this under the OECD so that they are consistent with the OECD rules.

But it once was much broader than that, but there are still some.

Mr. **Bailey**. When were those changes made?

Mr. **Sprinkel**. December 1980, they reduced the restraints on investments in Japan, but these restraints remain.

Mr. **Bailey**. Could you give us a little bit, if you have the knowledge—I am sure you do—of the history of those restraints and what other industries were affected?

Mr. **Sprinkel**. I would be glad to get it for you, but I cannot go back in that period. I know it was a very highly controlled economy historically, and also in the early postwar years. They have been moving fairly consistently toward liberalization. They are not quite there yet. I can get you more detail if you would like it, sir.

Mr. **Bailey**. Yes, I would.

[The information follows:]

Information Submitted by Mr. Sprinkel

INTRODUCTION

Postwar Japanese policy toward foreign direct investment

Just as there are numerous formal and informal barriers to exports to Japan, there are impediments to foreign direct investment in Japan. These barriers to direct investment also contribute to United States-Japanese trade frictions.

In the immediate postwar period the objectives of avoiding foreign domination of Japanese economic reconstruction and minimizing excessive or unexpected hard currency outflows resulted in the imposition of policies designed to foster the development of both sensitive and targeted industries in Japan. Industrial rationalization was fostered through a variety of mechanisms including the imposition of orderly marketing programs to reduce the intense competition for export markets and to improve profitability; the establishment of specialized agencies to provide inexpensive financing for various industries; joint research and development programs; and the encouragement of mergers to strengthen Japanese industries.[1]

Foreign investment was controlled under the 1949 Foreign Exchange and Foreign Trade Control Law and the 1950 Law Concerning Foreign Investment. Under this legislation foreign direct investment was permitted only subsequent to case-by-case government screening and approval. Majority foreign ownership in Japanese companies was restricted in a large number of industries including agriculture, forestry and fisheries, oil, leather and leather products, manufacturing, sales and leasing of electronic computers, data processing, retail operations, pharmaceuticals, utilities industries, and real estate.

Since July 1967, the application of Japanese investment laws have been progressively liberalized. The latest step in the liberalization was the enactment in 1980 of the Amended Foreign Exchange and Foreign Trade Control Law which freed all transactions in principle. Previously, all transactions had been prohibited in principle. Today, 100 percent foreign ownership is restricted in only four industries and eleven designated firms.

With the revision of the Foreign Exchange and Foreign Trade Control Law in 1980, the investment screening process was replaced with an investment notification process. Although individual investment notifications continue to be subject to review by individual ministries, no case of modification of an investment proposal has been reported since the implementation of the new law.

In May 1982, the Government of Japan included in its trade policy statements an official statement of welcome to foreign direct investors in Japan and encouraged Japanese private sector to welcome foreign products and foreign investment.

Over 30 years of formal and informal resistance to foreign investment at the local and national government levels and within the private sector in Japan have led to a lingering perception that the Japanese market is closed to foreign participation. This perception continues, in part, because of the residual regulations and restrictions on foreign investment, but perhaps more importantly because the competitive industrial environment cultivated since the postwar period is complex and expensive to penetrate. Thus, investors who have been unable to gain a substantial foothold in the Japanese market continue to perceive the Japanese market as, in many respects, closed.

EXCEPTIONS TO THE FOREX LIBERALIZATIONS

There are four sectors in which foreign investment is subject to special restrictions in Japan. These are: (a) agriculture, forestry and fisheries; (b) mining; (c) petroleum; and (d) leather and leather products. Under the new law, the Japanese Government retains the right to recommend the alteration or suspension of a proposed foreign direct investment notification if it finds that the investment might "adversely and seriously affect activities of Japanese business enterprises engaging in a line of business similar to the one to which the direct domestic investment is to be made, or to the smooth performance of the Japanese economy." (Article 27.)

In its October 1981 statement to the OECD Committee on Capital Movements and Invisible Transactions, the Government of Japan undertook to limit the application of the aforementioned criteria in reviewing direct investments to cases of direct investments in the four non-liberalized sectors listed above and to cases where "the amount of capital involved or other factors would result in the investment having an especially detrimental effect on Japan."

Under Article 21 of the new FOREX Law, the Government of Japan may also designate individual companies in which foreign investment will be subject to closer review and possible restriction when the investment would bring aggregate foreign ownership of the designated company to more than 25 percent. Companies may be designated by the Ministry of Finance on the basis of national security, public safety or possible serious adverse economic impact on Japan. There are presently eleven companies which have been designated under Article 21. They are:

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[1] Business International Corp., "Survey of Investing, Licensing and Trading Conditions in Japan." June 1981.

Name of company	Limit on foreign holdings (percent)	Current foreign holdings (percent)	Type of business or concern
Arabian Oil Co. Ltd	25	20	Mining.
Showa Oil Co. Ltd	50	50.02	Petroleum.
Mitsubishi Oil Co. Ltd	50	50	Petroleum.
Toa Nenryo Kogyo K.K	50	50	Petroleum.
Koa Oil Co. Ltd	50	50	Petroleum.
General Seckiyu K.K	49	49	Petroleum.
Fuji Electric Co. Ltd	26	23.4	Nuclear power.
Hitachi, Ltd	30	23.5	Nuclear power and weapons.
Tokyo Precision Instrument Co. Ltd	32	31.5	Aircraft instruments.
Katakura Industries Co. Ltd	25	24.6	Silk cocoon.
Sankyo Co. Ltd	25	23.8	Drugs and vaccines.

RESIDUAL BARRIERS TO UNITED STATES DIRECT INVESTMENT IN JAPAN

Historic problems

The current investment environment, though substantially liberalized for both Japanese and foreign firms operating in Japan, continues to reflect myriad factors that are an outgrowth of the postwar era. Many of these factors apply to both Japanese and foreign-owned businesses equally under Japanese law. However, because foreign firms do not have a substantial foothold in Japan, in practice these factors tend to put foreign-owned businesses at a disadvantage. They are as follows:

Cost of entry.—Start-up costs in Japan are very high relative to those in the United States and other foreign developed country markets. The complexity of the Japanese economy, together with the intense competitiveness of key Japanese industries, deters entry by many small foreign investors, as well as new Japanese entrants who cannot afford the legal counsel and numerous start-up costs associated with a new direct investment. These high costs are a key reason why many U.S. firms have chosen to invest in Japan via joint ventures. Equally important is the tendency on the part of U.S. investors not to be adequately informed about the Japanese market, legal system and culture.

Investment screening.—Despite the recent liberalizations in the amended FOREX Law, the Japanese Government retains extensive authority to control the flow of foreign direct investment. The prospective investor is required to file a detailed notification with the government, which reviews each investment for its impact on the industry. Since 1980, foreign direct investment in Japan has remained small. We have heard of no specific industrial complaints, however, or of any modifications of proposed investments. Thus, more time will be needed to assess the impact of the new laws.

At the local level there are additional delays associated with obtaining local start-up permits related to land acquisition and/or construction of manufacturing facilities. In the retail sector, for example, despite the fact that this industry was liberalized for foreign investment purposes in 1975, local commercial interests, working through local governments can block the establishment of new investments.

In our discussions with the Government of Japan the United States has encouraged Japan to make its pre-investment notification procedure more transparent, either by publicly indicating what factors would cause the government to modify or reject an investment, or to modify the procedure by substituting a simple investment registration system for the pre-investment notification. We have also generally pressed for national treatment for U.S. companies in Japan, and in particular solicited concrete Japanese measures to implement its stated policy of welcoming foreign investment.

Constraints on acquisitions by equity investment in Japan.—An alternative avenue of investment, commonly used in the United States by foreign interests, is equity takeovers of existing, listed national firms. These are not prohibited under the FOREX Law. But this avenue is essentially closed to U.S. and Japanese investors as Japanese customs and fair trade factors preclude hostile takeovers.

The distribution system.—The Japanese distribution system is characterized by long-standing buyer/supplier relationships. The system of linkages between manufacturers' financing organizations and established chains of distributors and retailers fosters preferences to buy from established firms at the expense of foreign and other Japanese firms. U.S. exporters or direct investors whose products may well be competitive may, therefore, find that the distribution system itself constitutes an important barrier to market access.

Foreign investors may face the additional problem of having difficulty in recruiting essential technical and management staff, knowledgeable about the industry in which the investment is to be made. Lifetime employment practices in Japan make it difficult for new foreign companies to attract middle and senior staff from established firms.

Restrictions on foreign participation in Japanese Government-sponsored research and development projects

Foreign-owned companies may not be eligible to participate in government-sponsored R&D projects in Japan. These may also play an important role in impeding investments by U.S. high-tech companies as Japanese companies may be reluctant to form joint ventures with U.S. companies, as such partnerships would entail their own exclusion from eligibility for such programs.

The American Chamber of Commerce in Japan's 1982 report on barriers to trade and investment

The American Chamber of Commerce in Japan recently made public the results of a study on current barriers to trade and investment. The study confirms that Japanese business regulations, even when applied uniformly to both Japanese and foreign-owned corporations, are widely perceived as having the effect of being more limiting on foreign-owned firms. Findings are based on data supplied by 147 members of the ACCJ; representing 30 percent of the total membership polled in the course of the study. Restrictions fall into the following major categories.

Japanese business regulations and practices:

Restrictions on procurement.—The client's/customer's ability to utilize foreign-owned firms' goods and services is restricted primarily in the transportation, energy and insurance sectors.

Government procurement practices.—Respondents stated that Japanese Government procurement practices favor Japanese companies. This is particularly the case in the transportation, high-technology and machinery manufacturing sectors.

Standards regulations.—Exclusion from the standards formulation process; the lack of Japanese harmonization with generally accepted international standards; lengthy, complex and expensive testing procedures; the refusal to accept test data generated outside Japan; and the necessity of recertifying goods which foreign-owned firms previously had certified for export purposes to Japan, are commonly cited problems.

Distribution system.—Respondents claim that Japanese customers make a conscious effort to buy products and services from established Japanese firms. Tradition, culture bias, close ties between manufacturer/customer/supplier are the reasons given.

Additional regulations and practices affecting high-technology companies

The NTT/KDD telecommunications monopoly will not permit sublicensing of data communications networks.

Government procurement, other than recent NTT agreements, is closed to U.S. systems.

U.S. companies are discriminated against in their efforts to market products to NTT-related equipment manufacturers.

Governmental subsidies and soft-loans to finance advanced technology R&D are not available to joint ventures or partnerships which include U.S. firms.

Mr. **Bailey**. One thing: I disagree with your administration on many issues, and I guess that is typical for politicians to disagree, but you know you have shown some backbone that has not been shown in recent years for sitting down in private, and talking to the Japanese, and trying to make them understand and see what the problems have been.

You should be openly complimented for that.

Mr. **Sprinkel**. Thank you, sir.

Mr. **Bailey**. We have not had that practice in the past.

I cried during the previous administration, myself, and a whole lot of other Congressmen and Senators, trying to get them to do that. You people appear to be far more successful at that.

That leads to this question: Are we making rapid enough progress? I view the Japanese practices in many ways as being very dangerous. I think in many ways they have contributed to the rise of protectionist feeling here and around the world. I really do.

I have written to them personally saying, please understand your practices are creating tension and criticisms that cannot be answered by politicians like myself. I cannot say to an American worker or businessman that we are playing by the same rules, and we try to be open and at least in that spirit you are not being open.

Are they making significant progress? I was very disturbed. You read the Wall Street Journal yesterday; you know what I am talking about with the cigarette thing.

Mr. **Sprinkel**. That is right. We took that issue up particularly and pushed very hard.

Mr. **Bailey**. What is your experience with that? How did that article hit you? Is it possible that that came from Government leaders, or could that happen without Government leaders being aware of it?

Mr. **Sprinkel**. No, it was a deliberate Government policy. That is one of the egregious examples. They moved to increase the number of retailers that can handle American brands, but not all of them. I guess by 1985 or 1986, it will move to coverage by all. But there have been those practices, and we worked hard to liberalize them.

What typically happens, as you would expect, they recognized the concerns here and abroad for their practices, and it is easier for us to maintain a free trade thrust which is where I think we must stay, if we are getting the same similar treatment there. It is very difficult to explain to Congressmen why free trade is good for us and not to them.

Mr. **Bailey**. I can't explain that to my people.

Mr. **Sprinkel**. I understand that. What happens is they will move a little bit, and they have moved a little bit, and——

Mr. **Bailey**. Grudgingly.

Mr. **Sprinkel**. Over a period of time, yes. As I pointed out a few moments ago, in the most recent list of actions they plan to take, we are monitoring carefully, and we are not very happy with the followthrough. We have made our unhappiness pretty clear. They keep saying yes, but we are going to, and we have done this, and we are going to do more, and I believe they will, but it is up to us to keep the heat on, from my point of view, because it is in their interests as well as ours in the long run.

Mr. **Bailey**. You are doing a better job than any of our administrations have. I really have to compliment you. I think you really touched on the political sensitivity I feel—I can't go to an American businessman or worker and explain the steel practices.

I will bring to your attention—you are probably not aware of it—there was a petition, H-o-u-d-a-i-l-l-e [spelling]—I don't know how to pronounce it—but dealing in the machine tool area there was a petition filed. I have concentrated particularly on the defense industry and basic industry issues. I consider it an assault there.

Has there been any change in the planning relationship, any policy adjustment, in your opinion, in Japan or abatement by MITI of what really are essentially strong recommendations practices that they make to the Japanese industrial sector in terms of looking at foreign markets for penetration purposes, and recommendations by the Government for tax advantages for certain domestic industries. Has there been abatement of that industrial policy?

Mr. **Sprinkel**. I think Ambassador Brock would be a better expert on that. I have general knowledge, but I am not expert in that particular area.

Mr. **Bailey**. OK.

Mr. Chairman, could I pass to Mr. Frenzel, with possibly one or two brief questions at the end?

Chairman **Gibbons**. All right.

Mr. **Bailey**. Thank you, Mr. Chairman.

Mr. **Frenzel**. Thank you, Mr. Chairman.

Mr. Under Secretary, I thank you for your testimony. It has been an interesting topic. I think our subcommittee generally believes that it is one of the items of critical importance that we are reviewing, and that it is the item of critical importance of which we know the least, and have the least possible understanding.

You indicated that you wanted to continue to go forward with opening Japanese investment, and I agree with that general policy. However, in the short and maybe intermediate term it tends to drive down the price of the yen.

Mr. **Sprinkel**. Probably.

Mr. **Frenzel**. That gives us a little pause. For the moment, there are restrictions on investment and personally, I would like to see them stay on until we have a little better handle on the market. What do you think?

Mr. **Sprinkel**. Well, I find, Congressman Frenzel, like many other economic policy issues, there is a short-run effect and a long-run effect. Frequently, they point in exactly the opposite directions. If you are unwilling to bite the bullet for the short-run costs, you don't get the longer-run benefits.

Our emphasis throughout this administration has been to attempt to focus on the intermediate term, so that we can, in fact, achieve objectives that we all agree upon. Therefore, it would be very difficult for me to suddenly say to my Japanese counterparts, yes, in the long run I wish you would open up those capital markets, but why don't you keep them where they are today or even tighten up?

I think it would be counterproductive, and I couldn't carry that message; somebody else would have to carry it.

Mr. **Frenzel**. Thank you for that.

Do I understand the thrust of your statement to be, would I be repeating it with some faithfulness if I said you could find no evidence of hanky-panky, we are then forced to the temporary conclusion we are looking at a market rate?

Mr. **Sprinkel**. Could you get a little closer to the mike, sir? The acoustics are getting me.

Mr. **Frenzel**. Would I be repeating the thrust of your testimony faithfully if I summed it up as a statement that says you have found no evidence of manipulation of the rates and that in the absence of that evidence you are forced to at least the temporary conclusion that the dollar-yen relationship is a market rate?

Mr. **Sprinkel**. Yes, sir. That is exactly my conclusion. I am perfectly willing to look at additional evidence if I could find it or someone would bring it to me and we do continue to search but up to now we have found no evidence whatever of them trying to weaken the yen. We have a great deal of evidence that in fact they are trying to do the opposite but not very successfully.

Mr. **Frenzel**. That is what I have been telling my European friends for 4 years and they dismiss me as hopelessly naive. I am glad to know there is another person who is possessed of similar naivete.

It is my observation that sometimes the market doesn't do what economists or business people would like it to do. I remember a couple years ago when the price of beef was escalating rapidly. American housewives just couldn't wait to buy more. To me it was heavily overpriced and I was happy with spaghetti and bread and stuff, and I knew that meat was overpriced, but the market didn't and the market was perfectly happy to buy it.

Is that something like what we are doing with the dollar today?

Mr. **Sprinkel**. Well, there is a production cycle in meat animals. I used to be a farmer many years ago, and you know that when that price gets up, with sufficient time production will increase and reduce the price and I am sure there is some level of the dollar that will be too high. The problem is I do not know what it is. To the extent we maintain stability in our inflation rate, reasonably low inflation and inflation expectations, you know, I can't see a good reason why there is going to be a sharp decline in the dollar.

One argument was, as I stated, interest rates, and many people were convinced. Well, that information is no longer pushed. It has been tested and again shown to be wrong. So I am not convinced we are headed for a big fall with the dollar vis-a-vis the rest of the world so long as we continue to try to get better discipline of our fiscal and monetary affairs.

If we go the other direction, the dollar will do the same as it did in the late 1970's, down the chute.

Mr. **Frenzel**. The suggestion is that one of the reasons or some of the reasons that the yen is weak versus the dollar is that they have had a couple bad quarters and deficits that dwarf ours, plus our economy is incurring the wrath of our trading partners with practices such as those described by Mr. Bailey when he discussed with us the Wall Street Journal article.

So perhaps you are right. Perhaps the yen is not undervalued, perhaps there is risk there. My guess is, however, that it will continue to rise. It is not an inherent weakness in that currency.

Mr. **Sprinkel**. Their current account in 1981 was $4.8 billion.

This year our best guesstimate is it will be $8.5 billion.

On trade in 1981, the trade balance, they were running a surplus of $20 billion and this year we are estimating about $21 billion. There has been a significant slowdown in their exports. In fact, they are off at an annual rate of 6 percent.

Mr. **Frenzel**. Their current account was in deficit in 1979 and 1980?

Mr. **Sprinkel**. That is correct

In 1979 the current account was negative $8.8 billion; in 1980, the negative amount was $10.7; in 1981 it shifted to the surplus I mentioned.

Mr. FRENZEL. I guess the biggest trouble is that the world has come to have what I hate to describe as kind of a distrust of the Japanese trading practices. They have not been forthcoming or straightforward with us. We have tried to enter into agreements with them, they have not worked well. We sense no enthusiasm on the part of Japan to make them work with respect to opening up their own process.

It is a shame that we have to probe simply because we don't believe what the figures are telling us based on the experience, which I think has to be described as a belief in bad deportment by people who ought to be our best trading partners.

Mr. SPRINKEL. I understand that. I initially came from Missouri and I listen to the music but I watch much more closely what they do and that is why we monitor very carefully what is happening, and in this case I think the words and the actions are moving in the same direction and in the correct direction, but not as far as we would like to see them go.

Mr. FRENZEL. You have been very helpful. I hope you continue to keep this committee advised. If there are interesting new signs on the horizon, we would appreciate knowing.

Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

I was delighted to hear the remarks you made, Mr Frenzel, because you did a better job of placing my fears and frustrations in line, and I thank you, at least in terms of the confidence problem that people have in negotiating with the Japanese.

I just want that nice big strong economy and that fantastic people in a free world orbit solidly tied to us ad infinitum, and we will probably all get out of this century without that horrible, feared possibility of another world war. And really, the free world just does not need this pressure of competing national economies.

In that context, I want to ask a question. What if there were a sharp rise in Japanese consumer spending? Say there was a dramatic openness to the Japanese market? Say everybody sat down and said, I am going to do this? What effect would that have on exchange rates?

Mr. SPRINKEL. The domestic economy rises more rapidly?

Mr. BAILEY. Yes, and most of it was reflected in a desire for imported consumer goods.

Mr. SPRINKEL. It would tend to weaken the yen.

Mr. BAILEY. Oh?

Mr. SPRINKEL. If they had a more rapid growth in money, accelerated rate of income month and spending domestically, that would raise imports relative to exports.

Mr. BAILEY. And weaken the yen?

Mr. SPRINKEL. Yes, each one of these examples comes out the wrong direction.

Mr. BAILEY. OK. Let me ask you this: What would the long-term effect be? Can you speculate?

Mr. SPRINKEL. Longer term, we hope all the world's nations, the big ones especially and the smaller ones, get out of the doldrums that we are in, and trade is not growing, for example, today. In fact, it is contracting.

Mr. Bailey. Lets assume——

Mr. Sprinkel. And the main point is that growth in Japan, as well as in the United States and other countries, will raise standards of living, make possible greater trade, and it is a plus. Now the problem with the Japanese is that they would like to stimulate domestic economic activity because they have unemployment, not like we have but for them it is relatively high, but they fear the point that we just made, namely, if we accelerate the domestic economy, the yen will get weaker.

Mr. Bailey. And I was interested in more what the effects would be over a long time.

It seems to me if we have these competing policies at some point we will have to pay the piper and face the problem we have talked about here today. It just seems that a gradual movement that was toward a realistic market relationship on currency exchanges is obviously quite tied to an opening up of that economy and to a free access to it, and that type of thing.

That brings me to the question I had forgotten to ask. I am not so crazy about selling tons of American cigarettes there. Don't get me wrong, but politically it indicates to me, and obviously it can be exaggerated as to impacts on it, and I am not interested in that. But it tells you something about attitude and policy.

I do not want to indicate I do not want to sell any more cigarettes but to the extent it should illustrate the right way the trade issue be handled, that is the core question.

Are we talking about government political leaders, their knowledge? Or is this administrative decisions by somebody that works there?

Mr. Sprinkel. No, it is government because we have talked to them about that particular practice. It was a set of restrictive import practices that applies not only to cigarettes, it applies to citrus fruits.

As you know, and it applies to beef and to a deliberate government policy designed to protect their own domestic industries.

Mr. Bailey. Sooner or later the President or one of you spokesmen will have to get out and address this American perception of trade with the Japanese. It is an American issue that is way out front right now. It is going to blow up. I am here trying to do you a favor. I am giving you a tool with a handle on it, looks like a baseball bat, and hopefully it will be used to hit the mule over the head to get the mule's attention.

The thing——

Mr. Sprinkel. I used to drive mules, too. I know what you are talking about.

Mr. Bailey. I have a couple of donkeys back there but old Jack's hee-haw doesn't trumpet the right way.

Mr. Frenzel. Would the gentleman yield?

Mr. Bailey. Yes.

Mr. Frenzel. That cigarette thing was interesting. Cigarettes have been an egregious Japanese violation of protectionism and violation of free trade that everybody accepts. We have been gnawing on them for years to do something. They have been totally resistant.

The end of the Carter administration passed the tenure of Bob Strauss and the end of Rubin Askew and there began to be some negotiations. The Japanese moved a little bit and started throwing out a little bait to see if anybody would snap at it.

Our negotiators came back and felt that with our committee, we couldn't tell them what to do, we told them it was not near good enough, it was insufficient evidence of good faith or any fair opening of the market of the Japanese.

However, our negotiators went to their industry constituents who thought something was better than nothing and so we made that agreement.

I have to tell you, having been involved in this over the past 5 or 6 years, words cannot express my disappointment after having read that article in the Wall Street Journal yesterday. It wasn't a good deal to begin with, and then to find that the people who negotiated it never intended to live up to it, it is something that just breaks my little heart.

I thank the gentleman.

Mr. **Bailey**. I thank the gentleman.

We had a meeting with the Japanese parliamentarians and I got frustrated and left that meeting after it was clear to me we were being talked to death. We wanted to raise tough questions, and they didn't want to answer them. They sat and talked and talked and talked and talked and talked and talked, and we had busy schedules and the chairman was doing his best to be courteous with them and nice to them and so on. It was a nice meeting. I didn't want to be rude in public, but I left that meeting with an anger in me.

I am an American Congressman, I have people that are demanding things from me, I want to voice a couple of concerns. I am hoping for some kind of reason or some rational answer.

Nothing.

Deliberate discourteousness, desire to avoid even answering our questions. There were two other Congressmen in there that felt the same way I did and at different times left the meeting, and they raised the point with me.

But you are saying that the government leaders, the parliamentarians, have had to be aware of that, the parliamentary leaders?

Mr. **Sprinkel**. Surely. It is a political issue, they have a democracy as here. There are pressures from agriculture in particular in Japan that are very strong. We are doing our best to reverse them. You have to go to the top officials in the government and that is what we have been doing. We are making progress, but we are not there yet.

Mr. **Bailey**. What you are saying really points up the differences in these two systems that is glaring. If that policy decision were made even internally in an American administration, there is a limit to what is jawboning and bad faith.

We go to our legislature to write laws, you know the due process and notice value we have in the system. That leads us in a different direction when it comes to policy formation. That really is what I have been trying to develop in these hearings. I can't tell you how grateful I am for the comments you made because of what it indicates, that somebody behind closed doors sits back and plays a contemptuous game at least to some degree.

Mr. **Sprinkel.** But they are moving.

Mr. **Bailey.** Well, you know I sat in these hearings and I have tried to make the point that a lot of our problems are our failure to properly assess and deal pragmatically with economic policies existent in other nations. I am convinced that if we had done a good job of analyzing our basic industries problems we would not have gotten to this point with the reinvestment challenge we have.

Right now, to make this country competitive—we should not have passed that tax bill the way it came out. That is an opinion. OK?

What should have been done—and I know the different theories and I know there are honest differences of opinion, I realize that. We need to make a serious effort to divert resources in this country if we are to meet our defense capabilities in the future to assure reinvestment in basic plant and equipment in the United States.

Admittedly, honest differences of opinion about tax policies exist. But the point I make is that we also need to help in cooperation with our allies who are free countries. I think the Japanese have to recognize that no one is jealous of their success. We want to learn where they can teach us. I think we are happy to teach but we have had a good-faith approach to these problems.

Their people and their politicians have to understand that it is not just the United States getting angry at them and they are setting a bad example. They are strong, free, good people; it is a great culture, but they need to listen to guys like you more and don't be so gentle. They are not moving fast enough. I do not think they are.

We have been saying that for years. I attempted to demagog it for what it was worth and didn't feel that was the responsible thing to do. I still don't.

I hope you and the administration really go after that issue because that is something that turned my stomach. They are so damned unfair, so rotten to do that behind our back. If our President did something like that, we would hound him out of office, and we should.

Thank you very much. You are a very reasonable man and you obviously are very candid in your feelings. I really enjoyed your testimony and learned a great deal from you.

Thank you.

Mr. **Sprinkel.** Thank you, Congressman Bailey.

Chairman **Gibbons.** Thank you, Mr. Secretary.

Mr. **Frenzel.** If I may, Mr. Chairman.

Chairman **Gibbons.** Excuse me, Mr. Frenzel has some more questions.

Mr. **Frenzel.** Yesterday one of our witnesses indicated that such things as having local content bills pending in Congress which raise the threat that the Japanese external markets may be denied to them at some point in the game is likely to have a depressing impact on the yen relationship to the dollar.

Do you concur in that opinion?

Mr. **Sprinkel.** Are you speaking of the local content bill; is that correct? That would restrict Japanese exports to the United States.

Mr. **Frenzel.** That is correct.

Mr. **Sprinkel.** Which would tend to weaken the yen, that is correct.

Mr. **Frenzel.** As long as this bill pends, it is helping to shoot us in the foot?

Mr. **Sprinkel.** Yes, sir, that would be my conclusion.

Mr. **Frenzel.** Thank you very much.

Chairman **Gibbons.** Thank you, sir.

Our next witness is Caterpillar Tractor Co., Mr. Timothy L. Elder.

I might announce, I will not be able to get a quorum at 2 p.m. so the meeting for 2 p.m. is canceled.

STATEMENT OF TIMOTHY L. ELDER, WASHINGTON MANAGER, GOVERNMENTAL AFFAIRS, CATERPILLAR TRACTOR CO.

Mr. **Elder.** Thank you, Mr. Chairman.

I am Timothy Elder, Washington manager of governmental affairs for Caterpillar Tractor Co. I am pleased to come before you and briefly explain my company's position on H.R. 5133.

We at Caterpillar Tractor Co. oppose efforts to set local content requirements for products sold in the United States. Our reason: Local content laws are simply another form of protectionism. And American companies such as Caterpillar, and our employees, have the most to lose if protectionism becomes the rule.

My company exports a high percentage of its U.S. production. Our 1981 exports from the United States totaled $3.5 billion and provided jobs for some 31,000 U.S. employees. With this exporting experience we have a strong interest in free trade.

We're concerned that local content legislation, even if limited to the automobile industry, would damage the long-term interests of American exporters and their employees. Our reasons are:

One, a local content law would give a strong push to the protectionist trends which now threaten the international trading system during the current worldwide recession. That system has already come under severe strain as many countries seek ways to protect home markets. Pressure to abandon the objectives of free trade could prove irresistible to other nations if the United States were to forego its traditional leadership and resort to market protection devices such as local content requirements.

Two, industries that supply the automobile industry, such as steel and rubber, would literally have a captive domestic market. If legislation such as H.R. 5133 were enacted, the need to keep their products and prices competitive would be lessened. And herein is a major concern for my company, those same industries also serve as Caterpillar suppliers. If our costs for materials rise, we'll find it more difficult to compete effectively in global markets, and more difficult to provide stable employment for our workers.

Three, a basic purpose of local content legislation is to relieve economic pressure on both management and labor in automotive and suppliers industries. One effect of such artificial lessening of competitive pressures would, perhaps, be a tendency for wages to rise more rapidly in the U.S. auto industry. But the effect would actually extend far beyond the immediate focus of this leg.

Most Caterpillar workers, for example, are also represented by the United Auto Workers, and we've traditionally been expected to match the Detroit benefit package. But unlike the auto industry, Caterpillar is primarily an exporter. Our international competitiveness would be substantially weakened if we were forced to pay the same disproportionately high salaries as might be demanded of a protected domestic industry. In short, local content legislation won't solve current trade-related problems. It would merely shift those problems to U.S. exporters.

Finally, if local content requirements are successfully imposed on the automobile industry, it's logical to expect efforts to apply such requirements to other U.S. industry sectors. But in our case, extending local content legislation to protect U.S. manufacturers in the domestic market would not help. The challenge we face is to build products that can compete successfully against foreign-produced products anywhere in the world.

If we do that, our products will be competitive in the United States as well.

We're not persuaded that a local content law, whether it covers just the automobile industry or is extended to other sectors—will enable the United States to provide more jobs over the long run for Americans. In fact, we believe the impact will be just the opposite.

Mr. Chairman, I would be happy to answer any questions that you may have.

Chairman **Gibbons**. I think all the members of the committee are very aware of the fine role that Caterpillar has taken in providing jobs in America with high compensation.

As I understand your testimony, you say that this bill would adversely impact you?

Mr. **Elder**. Sir, we can only assume if the United States, which has traditionally led the fight for free and open trade, were to go the route of this legislation it would elicit a similar response from other nations. The bulk of Caterpillar's sales are in international markets and we sense a strong danger of retaliation. As our sales are decreased the opportunity for U.S. jobs are decreased.

We now have roughly 20,000 U.S. employees on indefinite layoff. We don't know when we will be able to call them back. This is the first time that Caterpillar has faced a domestic economic situation which was not offset by sales activity overseas.

But, we now have both domestic and international markets going soft at the same time. This condition makes it particularly important for us to preserve what markets we have and to try to protect ourselves against any sort of retaliatory activities.

Chairman **Gibbons**. Mr. Bailey?.

Mr. **Bailey**. Thank you, Mr. Chairman.

Thank you very much, Mr. Elder, for a fine statement. I want you to know that there is no intention to hurt you. That is not the intent of the legislation. It has arisen from a boiling cauldron of frustrations in trying to deal with barriers abroad by and large. It has arisen in many ways from a group of difficulties and policy failures in this country in response to realities of maintaining certain investment patterns, particularly in the types of industries that you represent although you are unique.

You have a unique product and your technology is unique. In order to protect the good of the Nation's general industrial base and particularly its defense indsutrial base—it is not geared at you.

It will probably fail before it is all said and done, but it is getting some attention because it is reflecting some justifiable complaints incidentally, and you haven't had to face that problem as much as other people have, although there are some challenges to you.

Mr. **Elder**. There are.

Mr. **Bailey**. I would like to hear you expound on those if possible. But in particular, bear in mind that an industry like yours or a country that perceives the need for the equipment you produce, if that country runs out there and subsidizes or protects its market, in many ways this bill is a reaction.

You know this is not something that would initiate the flood of retaliation, it is in response to unfair trade. I would not expect you to support it at all and I understand your complaints and your reservations and your disagreement with it and they are well-taken, but I did want to paint a broader picture.

You people do make fine products. Your diesel engines, which don't just go in your bulldozers, have just got to be the best in the world. You make some for trucks, too?

Mr. **Elder**. Yes.

Mr. **Bailey**. I have talked to truckdrivers, if I might compliment you on the record, who have said if they want to go out there and buy the best engine, they can get maybe a quarter million miles out of it before overhaul, they want to buy one of your engines.

Mr. **Elder**. That is good to hear.

Mr. **Bailey**. I have nothing to gain by saying that to you. I am one of those nuts interested in every aspect of American industrial capability. I have always been fascinated by the history of techology. You people build a fantastic high-compression diesel; I'll tell you, your engineering is terrific. I do not want to see anybody unfairly take it away from you.

We want to be sure the other nations follow the practices we do. If somebody beats you, it is going to be because they genuinely took a risk, invested, and built a better product. I do not think you are afraid of that competition.

Mr. **Elder**. That is very true, Congressman.

You mentioned the challenges we face. Our largest worldwide competitor is a Japanese firm, Komatsu. This firm expanded into our traditional markets. But that is fine. It keeps us on our toes. You may have seen a report to the effect that Caterpillar sales are way off for this quarter and are projected low for the next quarter. But at the same time we are continuing to plow money back into our business. We have an expansion plan for 1983 which will take about a half-billion dollars in investment.

Mr. **Bailey**. Let me say something along that line. I was very much aware of who your competitor was and where it came from. If typical practices of the past are followed in the case of your competition abroad, you are not going to be able to compete with it. You are not going to be able to compete with it.

The kind of deals you enter into in many, many cases involve extensive long-term financing in many situations. I am sure you are aware of that.

Mr. ELDER. Yes.

Mr. BAILEY. You will not be able to compete with them. It is not true in the Japanese case, there are legitimately lower interest rates in Japan. I have seen cases, believe it or not, where deals have been cut by virtue of a callback or an agreement with the Japanese Government to finance large sales of Japanese products abroad at interest like 2 or 2.5 percent. That is absurd.

Domestic interest costs were 8-something, 8.5 or something, of that nature. The Japanese Import-Export Bank were financing exports at about 9 percent. If they sold it in America it would have to be 11 percent. There is a certain agreement with the United States. These figures are a month or so old but nobody in this world is lending money at 2.5 percent, nobody.

I just want to say to you, you American businessmen, win or lose, I know you are as competitive as anybody in the world. But you can't fight that kind of practice. You can renovate, and you can modernize, and do you still make D-8's and D-9's?

Mr. ELDER. Yes.

Mr. BAILEY. Those are big powerful machines but you are not going to be able to fight a government-sponsored project to drive you out of business. Once that market is cornered, you are not going to get back in it.

Mr. ELDER. You touch on a good point, and that relates to a comment which our board chairman, Lee Morgan, made a few months ago.

Mr. BAILEY. Could you send me his remarks?

[The material referred to follows:]

REMARKS BY LEE L. MORGAN, NATIONAL PRESS CLUB

Thank you for that kind introduction.

And thank you for inviting me to speak about the competitiveness of U.S. exporters in the world marketplace. In the midst of a bad run of economic news here in the United States, it's especially appropriate that we look at how American business is faring in competition for international sales.

I'm pleased to be joined at this head table by Representatives Michel and Bonker; by Bill Draper, of the Eximbank; by Jim Booe, of the Communications Workers of America; by Will Barry, representing the National Governors Association; and by Jack Steiner of Boeing.

The presence of these distinguished guests underscores their commitment to a strong U.S. exporting capability, and their willingness to work hard to achieve it. Their presence also shows that export promotion is a goal shared by Republicans and Democrats, State and Federal Government Officials, and business and labor leaders.

Exporting, I'm sure you'll agree, is not about to replace sports or politics as a leading topic of conversation in the United States.

Americans are in favor of exporting as a general concept. It's just that relatively few know much about it . . . even though large numbers of Americans depend on exports for their jobs. Unfortunately, this relative lack of attention means that in policy level discussions here in Washington the export dimension often does not get the attention it deserves.

It is appreciation of the close link between jobs and exports, and the recognition that exports need to be placed higher on our Nation's priorities list, that led to formation of the coalition for employment through exports. This coalition includes State Governors and trade union leaders, along with large and small companies engaged in exporting.

The jobs-creating aspect of exporting is what I plan to focus on today. But I'll also discuss some of the realities of international competition for export sales. There are lots of aspects of U.S. Government policy that affect U.S. export performance. The use of economic sanctions as a tool of foreign policy, for example. Or the impact of the Foreign Corrupt Practices Act. But today I want to place particular emphasis on the crucial area of export financing.

Allow me to draw upon the experience of my own company to illustrate the important role of exports in helping to create jobs for Americans.

Caterpillar designs, manufactures, and markets products in two principal categories: earthmoving, construction, and materials handling machinery and equipment; and engines.

Caterpillar has been fortunate to enjoy a significant measure of worldwide success. For most of the past decade, our overseas business has equalled or exceeded our U.S. business. Last year, 57 percent of our sales were outside the United States. Some of those sales, of course, were of products manufactured abroad. But most came from the United States. In fact, nearly half of Caterpillar's total U.S. production in 1981 was exported . . . amounting to 3.5 billion U.S. exports.

We estimate that some 31,000 of Caterpillar's U.S. employees owed their jobs to exports last year. And the benefits didn't stop with our company or our employees. For each job at Caterpillar, it's estimated that two jobs are created with supplier firms that provide us with goods and services. So, in all, Caterpillar exports in 1981 created approximately 93,000 jobs for Americans.

We're proud of these figures. They're firm evidence that an American company . . . an American work force . . . can compete successfully in international markets.

But we *want* to do better . . . and we *can* do better. We think that annually there are billions of dollars of additional sales opportunities that Caterpillar and other American companies could and should be capturing. We're convinced that we could win more of that business under conditions of equal competition. But there's the rub; internationally, we're *not* competing on an equal basis, and the distortions to our international trading system are placing the American exporter at a serious disadvantage.

Governments of other countries are supporting financing arrangements so attractive that American companies are losing out. Government-supported financing of international sales has become a major factor in determining who gets what business. The U.S. general accounting office recently surveyed 117 exporters who had applied to Eximbank for financing support, but were denied loans or did not use them. The survey shows these firms lost over $2 billion worth of business to exporters from other nations with more competitive financing.

Traditional commercial factors such as quality, service, and price remain important; but a good financing package can, and often does, dominate a purchasing decision, It is crucial, then, that American exporters have available a financing facility on a par with facilities available to our foreign competitors. That is why the U.S. Export-Import Bank is so important to this Nation.

If Eximbank is so necessary and desirable, then why does it face such significant pressure to cut back its operations? Fundamentally, I believe, because it is the most misunderstood institution in the Federal Government.

Unfortunately, many people do not understand the positive aspects of the Eximbank's activities. For example, few people know that since its initial establishment, no taxpayer dollars have been appropriated to support the Eximbank. Few people know that the bank is a money-making proposition; so much so that it has paid back its $1 billion original capitalization to the U.S. Treasury and has piled up $2 billion in retained earnings to help see it through tough economic times, like the present.

You know, when viewed superficially, the Eximbank debate appears to pose a kind of ideological quandary for me, and for other business leaders. For years you've heard us appeal to Government to get out of our way, and let us compete. What we need—and we say it over and over—is less Government, not more . . . less Government spending, less Government regulation of the private sector, and less Government involvement in the marketplace. Let me strongly reassert those views today.

Exporters are not looking for a handout. We recognize and acknowledge that our Nation cannot and should not adopt a policy that calls for export credit subsidies over the longer-term. We agree with and wholeheartedly support the goal of multilaterally eliminating export credit subsidies as a competitive weapon. But we do not agree that a policy of unilateral export credit disarmament is the proper way to achieve that goal.

Let me explain what I mean by unilateral disarmament. I mean we cannot disarm our Eximbank—cutting back its programs—and expect other countries to negotiate with us on controlling export credits. Just last week the French indicated they are not prepared to approve the newly negotiated OECD agreement on export credits.

The United States will have little leverage in international negotiations if Eximbank is regarded as an insignificant factor in the international marketplace. And frankly, I'm afraid we're reaching that point.

Let's consider why that's a problem. American exporters want to compete . . . and are ready to complete . . . on the basis of quality, service, price, and other commercial factors. Those are, on the whole, factors for which the private sector is responsible . . . over which we have some control.

But export financing supported by foreign governments on behalf of their national industries confronts us with a dilemma . . . a dilemma for which there is no adequate private-sector solution.

American companies, regardless of size, don't have the financial resources to compete against very substantial export credit subsidies from foreign governments. Those subsidies, along with a vast array of other export promotion devices like tax incentives and tariff concessions, are helping foreign companies win exports and export-based jobs away from the United States.

It's in this context that an effective U.S. Export-Import Bank is essential . . . a competitive bank can help stem the loss of export-based jobs to other countries. And an aggressive bank will encourage other countries to join the United States in serious efforts to control predatory export financing. Agreement is needed in this area if purchasing decisions in international trade are to be based more on commercial factors . . . and less on which government offers the biggest financing subsidy.

Unfortunately, the experience of recent years indicates that an agreement on export financing will not be achieved easily.

The United States has tried to achieve such an agreement, employing a combination of exhortations and warnings. But so far, we've fallen short of reaching an effective and lasting solution.

One important reason, I believe, is that other countries have seen too many indications that the United States does not attach the same high priority to exporting that many of them do.

Other countries see export credit subsidies as creating foreign exchange earnings and jobs. So long as these gains appear to outweigh the costs involved, they're prepared to continue export credit subsidies, and resist any effective international agreement. We can change the equation for them by fighting back every time another country offers a financing package aimed at displacing U.S. exports and jobs.

In theory, that's what Eximbank's current policy of "selective competition" is intended to do. But Exim's authority and resources are so limited that the Bank has to put more emphasis on selecting than it does on competing.

That situation must be changed. In the longer run interest of achieving agreement on an end to predatory export financing, the United States needs to strengthen eximbank . . . or other countries will continue to have no real reason to come to the negotiating table.

Various arguments have been put forth as to why the United States cannot or should not have a strong Eximbank . . . some based on misunderstandings about the bank. I'd like to address some of those arguments and misunderstandings.

One is that Eximbank, like many Government programs, is just too expensive.

Earlier, I disputed this charge by noting that Eximbank has made money throughout its existence. There are few, if any, government agencies that can boast such a record.

This year, for the first time in its history, Eximbank will lose money. Interest rates have soared and conditions in the money markets that permitted the Bank to make a profit in the past are now reversed. Currently, Exim is having to borrow at higher interest rates than those at which it must lend, if it's to compete with the export loan rates offered by other industrialized nations.

It's not really surprising, then, that there have been calls to cut back Eximbank's programs. But while calls for cuts in Eximbank's programs may not be surprising, neither are they logical. It is precisely during a period of economic uncertainty and high interest rates that we most need a strong Eximbank. And it is precisely in tough economic times that a viable financial or commercial institution should be able to draw on those resources it has accumulated over the profitable years.

There's a second misunderstanding about Exim that also deserves comment. That is the widely held impression that it benefits only a few big companies. Not true! Last year Exim was used directly by more than 2,600 U.S. firms.

Eximbank has a variety of programs, some of which—like the discount loan program—were developed with small and medium exporters in mind. And even when Exim helps promote exports by large firms, thousands of other companies across America share in the benefits of those export contracts. I am referring, of course, to the suppliers, subcontractors and vendors to the exporters. Let me illustrate this point.

Caterpillar in 1981 bought goods and service from over 14,000 U.S. suppliers, located in all 48 contiguous States plus the District of Columbia. In a sense, we served as the export department for those companies, many of which are small businesses.

Boeing purchases commercial aircraft parts and equipment from some 4,000 suppliers. And Westinghouse estimates that about half the value of the goods manufactured for a typical 2,000-megawatt nuclear equipment export orders comes from suppliers and subcontractors.

I won't deny that Caterpillar, Boeing, Westinghouse, and other large companies that are often associated with the Eximbank do benefit from that association. But I'm not embarrassed by that fact, since such companies account for a surprisingly large share of total U.S. exports. The point of these examples is that the Bank's positive impact is much broader than a few big companies.

Let's move beyond companies, to talk about people. A survey of U.S. manufacturers by the Census Bureau shows that each billion dollars worth of exports supports more than 30,000 jobs. (Caterpillar's own experience, incidentally, bears out this estimate.) The key point is that since all Eximbank funding supports U.S. production, the Bank has a sizable effect on American jobs.

American jobs . . . that's what this is all about! U.S. unemployment has reached its highest level since the Depression of the 1930's. By the end of June, Caterpillar will have over 17,000 U.S. employees on indefinite layoff . . . the largest number of layoffs in our company's history.

In my view, one of the most important things Government can do to help restore economic health is to encourage job-creating, wealth-producing activity like exporting. To the extent Federal funding is involved in supporting Eximbank activities, it has a high payoff at a low cost.

There's a third misunderstanding I'd like to talk about. It relates to exporting generally . . . not just to Eximbank.

It's the belief that other countries are lined up eagerly waiting to buy American exports. So it doesn't really matter what we do in terms of public policy affecting exports. The United States can impose export controls or weaken Eximbank . . . and American exports will continue to sell themselves.

Well, it used to be the case that the United States could lock up international sales easily because of our technological edge. But that's no longer the case. Our foreign competitors have closed the gap in most areas where America once held technological superiority. Machinery and engines, steel mills, aircraft, nuclear and fossil-fueled powerplants are no longer the private technological turf of American manufacturers.

Now we find ourselves offering essentially competitive products, but with the export financing factor working against us. If we fail to rise to the export credit challenge, American exporters will find themselves replaced as the customary suppliers in important markets. And once you're out of an export market, it is very hard to regain your former position . . . much harder than in the case of domestic markets.

Let me provide some specific examples of the role competitive export financing can play and has played in regard to products now available from various countries.

An executive of Singapore Airlines has been quoted as saying the reason his firm exercised an option to buy four more Airbus A-300's from Europe—instead of buying from Boeing—is the $40 million they would save with French financing.

In the case of a $1 billion nuclear power project, the difference in financing costs between the lowest rates offered by foreign competition and those offered by the United States can mean as much as $500 million over the life of the plant.

One of the clearest—and, from a U.S. perspective, worst—examples of the impact of competitive export financing is found in Caterpillar's own experience. A year or so ago we were bidding for the sale of 40 machines to a potential Latin American customer . . . machines Caterpillar built in two places: Illinois and the U.K.

Customarily, we source products sold in Latin America out of Illinois, and that was our intention in this case. That is, until financing became a factor. The buyer was aggressive in seeking financing . . . and arranged such favorable terms through the British export credit facility that he insisted our product be sourced from the U.K.

The impact: The buyer got his caterpillar equipment; and we got the sale. But most of the jobs went to the U.K. instead of to the United States . . . purely and simply because our Eximbank could not, or would not, meet the terms offered by the British.

These examples illustrate why American exporters are so concerned about proposals that would cut the authorization level of Eximbank in fiscal 1983, at a time when the availability of funds from the financing facilities of other nations appears to be growing.

A host of solutions have been suggested to bring an end to the current international export credit war. I will mention only three because they fall within the framework of present institutions and policies.

First, we could get rid of our Eximbank and assume that the aggressive exporting nations we compete against will also eliminate their banks. You know as well as I do that that's not going to happen.

Second, American manufacturers could start sourcing their export orders through manufacturing facilities located in countries that are eager to provide export financing. But American companies don't want to do that, and I'm sure that solution is not palatable to Government and labor leaders.

Or third . . . in the vernacular of Washington . . . we can "play hardball." The United States can put other nations on notice that we are going to match their export credit packages with competitive financing of our own. We can show them that our Eximbank is going to actively promote American exporters by assuring them they will get the financing they need, rather than withdrawing from the contest.

Some call this the "deep pocket" approach, based on the fact that America's capital resources are the largest in the world. We believe this deep pocket solution would provide the show of financial power and credibility our negotiators need to bring about more effective agreements on export loan interest rates and terms.

The place to start is with Eximbank's program authorization.

The realities of international competition would call for a substantial increase in the Eximbank authorization level. The realities of U.S. politics and fiscal policy, on the other hand, demand restraint. In the past, compromises have been achieved which preserved an appropriate balance between our commitment to a strong Eximbank and U.S. fiscal policy. We believe it is incumbent on policymakers, both in the executive branch and Congress, to recognize the positive economic benefits—including jobs creation—that flow from Eximbank, and accord it appropriate priority in the budget setting process.

To complement adequate funding, other changes in Eximbank lending practices must be made. Too often, for example, the bank's commitments are not timely, And the current practice of charging an up-front fee of 2 percent seriously undermines the value of Exim's support.

The U.S. Eximbank is just not competitive in many cases. Other OECD countries, by use of mixed credits and other financing tools, have been able to bring their effective rates to a level below that provided for in the international accord. The comparable U.S. rates are often several percentage points higher.

The Bank should have a broad range of programs that meet the needs of the diverse companies that make up America's export sector. In addition to the direct loan program, Exim should have strong programs in such areas as discount loans, guarantees, and insurance.

Congress must make it clear that Eximbank is not to be a passive partner in the world of international finance. In renewing Eximbank's charter, Congress should reconfirm the Bank's mandate to be an aggressive promoter of U.S. exports. Eximbank's role must be effectively integrated with the other export promotion activities of the U.S. Government.

A strong U.S. commitment to Eximbank would signal the rest of the world that we are serious about exporting . . . and about export financing competition. Other countries must know that we don't intend to stand idly by watching American jobs be snatched away as a result of their export credit subsidies. They must be put on notice that if we're forced to play the export finance game, we'll play vigorously . . . and we'll win.

Caterpillar, and many of our associates in the business community, have consistently spoken out on behalf of both free trade and a reduced role for Government in the marketplace. We remain committed to those positions. We do not advocate strengthening Eximbank out of a desire to increase U.S. Government involvement in international trade. Rather, a stronger Eximbank now is the most effective way to help American firms compete on a fair basis in the international marketplace. And a strong Exim is a powerful incentive for other countries to agree to controls on predatory export financing.

We need such an Eximbank policy to encourage the vigorous growth of American exports . . . and, in the process, put a great many Americans back to work. I urge all of you to do your part to help achieve these goals.

Mr. ELDER. Yes. He was addressing the subject of Eximbank financing. You know, a basic Caterpillar philosophy, is that if we are comparing "iron to iron" we build the best product in the world.

Mr. BAILEY. I think you build the best by far.

Mr. ELDER. But our market is changing to the extent that being the best in the industry is not the answer any longer. Financing is an increasingly important part. On a related note is the yen problem. We are taking a very close look at the yen—where it is and how it got there. I will offer you a first-draft piece which we have put together on the undervalued yen.

[The material referred to follows:]

THE YEN—AN UNDERVALUED CURRENCY

After World War II, Japan had many underemployed workers, a war-weakened economy, and little foreign exchange. Faced with those problems, the government set "growth, investment, and exports" as its goals. Policies were very successful—Japan moved from being the eighth largest exporter in 1955 to the third largest exporter today (Table 1).

TABLE 1.—MERCHANDISE EXPORTS

[Billions of U.S. dollars]

	1955	1980	1980 rank
United States	$15.6	$220.7	1
United Kingdom	8.5	115.1	5
West Germany	6.1	192.9	2
France	5.0	116.0	4
Canada	4.6	67.6	7
Belgium	2.8	64.5	8
Netherlands	2.7	73.8	6
Japan	2.0	130.4	3

Source: IMF, International Financial Statistics.

Even though Japan's postwar problems were overcome long ago, its public still believes fast export growth is needed to pay for raw materials and to counteract domestic business cycles. Two oil crises reinforced the idea that Japan's external position is vulnerable. Therefore, the public supports policies which encourage exports, even if they impose a cost on consumers.

One policy the government uses is to keep the yen undervalued. This is done by (1) restricting foreign investment and (2) increasing private capital outflows and officials holdings of foreign exchange whenever the trade surplus widens. Those actions offset excess demand for yen and limit its appreciation.

We've reviewed other opinions, and there is widespread agreement the yen is currently undervalued. Most suggest a rate of 180–200 yen per dollar would adequately match Japanese goods with those of other countries, based on production efficienies. Even many Japanese businessmen admit they could still export profitably at 200 yen to the dollar.

Opinions differ on why the yen is now undervalued. Some believe it is only a short-term problem reflecting the current large differences between U.S. and Japanese interest rates. They argue that the yen will cease being undervalued once U.S. interest rates decline.

We believe that high U.S. interest rates are contributing to the yen's undervaluation but that undervaluation will continue even after U.S. interest rates fall. One reason is that Japan's net private capital outflows were only about $2 billion in 1981. While that is a large swing from 1980's $19 billion net inflow, it is still well below net outflows experienced in most years during the 1970s. Additionally, short-term money, which should be most sensitive to interest rates, actually flowed into Japan in 1981 (about $4.5 billion). And part of long-term net outflows ($4.7 billion out of $6.5 billion) were direct investments outside Japan—probably made largely because other governments insisted on more Japanese investment in their countries.

Second, we believe the yen was persistently undervalued throughout the 1970s—a period in which interest rates weren't a problem. To show that, we used an estimated equilibrium of 185 yen per dollar in 1981 (a rate we think would have existed without government manipulation) and used differential rates of inflation to estimate past equilibriums (Table 2). Those calculations show the yen was seriously undervalued in the early 1970s as well as being undervalued recently—comparisons which most observers would find valid.

TABLE 2.—JAPANESE EXCHANGE RATES AND SHARE OF EXPORTS

	Exchange rates (yen per dollar)			Japan's share of industrial country exports 1 year later—(percent)
	Estimated equilibrium	Actual rate	Percent undervalued	
1972	192	303	−36.6	9.2
1973	204	272	−25.0	10.4
1974	226	292	−22.6	9.8
1975	223	297	−24.9	10.6
1976	225	297	−24.2	11.3
1977	225	269	−16.4	11.4
1978	219	210	+4.3	9.7
1979	207	219	−5.5	10.5
1980	196	227	−13.7	12.4
Average	213	265	−19.6	

Note: We used implicit GNP deflators for calculating past equilibriums, but using consumer or wholesale prices would give similar results. From 1972 to 1980, Japanese inflation was slightly higher than U.S. inflation.

Source: IMF, International Financial Statistics; Economics G.O. estimates.

But our calculations also show the yen was undervalued in most intervening years. Not everyone agrees with that since the yen's value fluctuated widely in that period. Our purpose is to show that government actions throughout the 1970s support the idea that the yen was consistently undervalued—on average, about 20 percent.

Such a large undervaluation means that Japanese consumers and businesses paid additional costs in the form of higher prices, primarily for raw materials. For that reason, some argue that the Japanese Government wouldn't deliberately keep the yen undervalued.

We disagree with that notion. The government has long set artificially low interest rates on a large part of consumer savings. That is a widely recognized examples of the government imposing a cost on consumers to subsidize businesses (and government). So the government wouldn't avoid undervaluing the yen solely because of concern about consumer welfare.

Also, consumers and businesses probably feel the cost isn't too high for the benefits—stable employment and production. Imports are only 10 percent of GNP and a 20 percent undervaluation causes a 2 percent higher absolute price level for the economy. Moreover, a steady rate of undervaluation doesn't increase inflation in subsequent years. But exporters enjoy a 20 percent price advantage over competitors each year. They can usually sell most production, penetrating new export markets if needed, and keep employment stable or growing.

As examples, the yen weakened in 1974–75 and again in 1979–80 while the rate of undervaluation held steady or increased. In both periods, the world was struggling with sharp increases in oil prices and economic growth slowed. But Japan's share of industrial country exports (fourth column of Table 2) increased significantly. The undervalued yen allowed the Japanese to accelerate exports, helping pay for much higher oil import bills. The yen weakened more than necessary for Japanese exporters to hold their share of trade.

The final advantage of undervaluation is that it facilitates Japanese promotion of new export products when traditional ones come under protectionist pressures.

HOW THE JAPANESE GOVERNMENT KEEPS THE YEN UNDERVALUED

Table 3 gives a broad outline of the Japanese foreign exchange market. The left column shows transactions in which yen is demanded in exchange for foreign currencies. Increases in the amounts of such transactions strengthen the yen's value.

The right column shows transactions which cause yen to be supplied in exchange for foreign currencies. Increases in those transactions weaken the yen.

With freely floating exchange rates, exchange rate changes balance supply and demand of a currency. But governments can also balance supply and demand by manipulating some of the underlying transactions. When that happens, the exchange rate is no longer a "market rate." The Japanese Government intervenes in three ways:

1. Foreign investment (including that in interest-bearing instruments) in Japan is usually limited.
2. Japanese investment abroad is encouraged whenever the trade balance is increasing.
3. The government increases reserves whenever the trade balance is increasing.

TABLE 3.—*Japanese foreign exchange market*

Demand for yen	*Supply of yen*
Japanese exports of goods and services.	Japanese imports of goods and services.
Foreign investment in Japan (capital inflows).	Japanese investment abroad (capital outflows).
	Increases in official Government reserves.

Note: Most Japanese exports (about 70 percent) are paid in dollars. So Japanese exporters, rather than foreign importers, actually demand yen in exchange for dollars.

The net effect is to limit yen demand largely to exports. And when yen demand exceeds supply, the government relieves upward pressure on the yen by sending excess foreign exchange abroad or holding more as reserves. Thus exporters continue to benefit from an undervalued yen.

Japanese capital controls

Japan's balance of payments historically showed a tendency towards surplus, except after the two oil price shocks in 1974 and 1979. The payments history can be divided into five periods:

1. 1971-73—Adjustment to floating exchange rates.
2. 1974-75—First oil price shock.
3. 1976-78—Recovery from the first oil price shock.
4. 1979-80—Second oil price shock.
5. 1981-present—Recovery from the second oil price shock.

In periods one and three, Japan ran payments surpluses, mostly because of large trade surpluses. In both periods, the government tried to increase net capital outflows to offset trade surpluses. They did that by restricting inflows and encouraging outflows. In periods two and four, they did the opposite to prop the yen's value. Data on period five isn't complete but it seems much like periods one and three. So the government reversed policies four times in ten years—clear evidence of an intention to influence exchange markets.

Below is a summary of the major controls the Japanese Government used in the first four periods, as documented in the International Monetary Fund's annual reports on *Exchange Restrictions.*

1. 1971-73—Government tried to increase net capital outflows to weaken the yen.

a. Actions taken to reduce inflows

Restricted nonresident stock purchases.
Forbade Japanese residents to issue bonds abroad.
Limited Japanese bank borrowing abroad.
Established marginal reserves on nonresident free yen accounts.
Wouldn't allow nonresidents to buy Japanese Government short-term securities.

b. Actions taken to increase outflows

Eased restrictions on overseas direct investment and stock purchases.
Started allowing foreign governments to issue bonds in Japan (Samurai bonds).
Raised amounts of currency travelers could take abroad.

2. 1974-75—Government tried to reduce net capital outflows to strengthen the yen.

a. Actions taken to increase inflows

Eased restrictions on nonresident purchases of Japanese stocks and bonds.

Eliminated marginal reserves on nonresident free yen accounts.

Encouraged Japanese residents to issue bonds overseas.

b. Actions taken to reduce outflows

Reduced amount of currency travelers could take out of the country.

Instructed banks to be more restrictive in granting loans for overseas investments.

Discouraged foreign stock purchases.

Restricted bank medium- and long-term overseas lending.

Limited resident foreign exchange holdings.

Suspended Samurai bond issues.

3. 1976–1978—Government tried to increase net capital outflows to weaken the yen.

a. Actions taken to reduce inflows

Stopped nonresident purchases of government securities and short- to medium-term bonds.

Enacted marginal reserves on increases in nonresident free yen accounts (100 percent margin took effect on March 18, 1978).

b. Actions taken to increase outflows

Raised amount of currency travelers could take abroad.

Gave commercial banks more freedom in financing overseas investments.

Ended restrictions on resident purchases of foreign stocks.

Started allowing Samurai bond issues again (increased frequency of issues on October 13, 1976).

Encouraged banks' overseas lending (blanket approval of foreign exchange bank lending started on July 1, 1978).

Raised amount of foreign currency residents could hold.

4. 1979–1980—Government tried to reduce net capital outflows to strengthen the yen.

a. Actions taken to increase inflows

Encouraged nonresident stock and bond purchases.

Eased controls on Japanese companies issuing bonds.

Eliminated marginal reserves on nonresident free yen accounts.

Ended ban on short-term impact loans (foreign currency loans to non-bank residents).

Allowed nonresidents access to the gensaki market (conditional sales or purchase of a government or corporate bond with specified repurchase or resale terms).

b. Actions to reduce outflows

Asked banks to be prudent in lending overseas.

Effects of controls on capital inflows

Japan has long had tight controls on foreign ownership of Japanese companies. Consequently, foreign direct investments in Japan averaged less than $200 million yearly during the 1970s—virtually nothing for an economy which now produces over $1 trillion of goods and services yearly. Table 4 shows that foreign share equity purchases were also quite small until 1980. They jumped significantly that year because the government actively promoted such investments.

TABLE 4.—FOREIGN INVESTMENT IN JAPAN

[Billions of U.S. dollars]

	Share equities	Short-term capital inflows
1972	$0.7	$2.7
1973	−0.6	7.8
1974	−0.9	12.6
1975	1.5	0.4
1976	1.6	2.0
1977	1.3	−1.6
1978	1.7	11.9
1979	2.4	14.3
1980	11.9	31.9

Source: Statistics Bureau, Monthly Statistics of Japan; Chase Econometrics' data bases.

Short-term inflows varied cyclically. Peaks were in 1974 and 1980 when the government encouraged inflows. Inflows were much smaller in intervening years when the government tightened controls to cope with rising trade surpluses. So both long- and short-term inflows responded to the Japanese Government's wishes.

The jump in stock purchases in 1980 suggests considerable latent demand for Japanese equities. Japanese stocks outperformed U.S. stocks since 1970 (Table 5), which further substantiates that hypothesis. In the 11-year period shown, Japanese stock prices fell only once compared to five times in the United States. Japanese stocks outperformed U.S. stocks seven of those 11 years.

If a U.S. investor had placed $100 in the U.S. stock market in 1970, his purchase would have had a value of $143 in 1980 (assuming average gains). Had he been able to place $100 in the Japanese stock market in 1970, his investment would have had a dollar value of $460 in 1980—over eight times the gain in U.S. stocks. A bigger increase in Japanese stock prices, plus appreciation of the yen, caused that huge differential.

TABLE 5.—COMPARISON OF U.S. AND JAPANESE STOCK PRICES

	Percent increase	
	United States	Japan
1970	−14.9	8.2
1971	18.1	9.9
1972	11.1	57.2
1973	−1.6	28.3
1974	−22.9	−15.2
1975	4.0	1.6
1976	18.4	11.4
1977	−3.7	8.4
1979	−2.2	10.3
1979	7.3	8.3
1980	15.3	5.4

Note: U.S. stock prices were up 21 percent over the entire period; Japanese stock prices were up 214 percent.

Source: Standard & Poor's index for U.S. stock prices. Average stock price index on Tokyo Stock Market, First Section for Japanese stock prices.

Had the government followed consistent, less restrictive capital policies throughout the 1970s, capital inflows would have been larger in nearly all years—and the yen would have been stronger.

Effects of controls on capital outflows

Table 6 shows average yearly capital outflows for five different historical periods. Outflows are lagged one year to allow for an investor response to changes in government policy. In general, outflows responded to the Japanese Government's wishes.

TABLE 6.—JAPAN'S PRIVATE CAPITAL OUTFLOWS

[Billions of U.S. dollars]

Period	Apparent Government objective toward yen	Average capital outflows 1 year later [1]		
		Long term	Short term	Total
1969–70	Fixed exchange rate	−$2.0	−$0.5	−$2.5
1971–73	Weaken	−4.9	−3.3	−8.2
1974–75	Strengthen	−4.0	−0.6	−4.6
1976–78	Weaken	−12.5	−5.1	−17.6
1979–80	Strengthen	−10.8	−15.4	−26.2

[1] Increases in outflows weaken the yen.

Source: Chase Econometrics' data bases.

In 1971–73, average outflows nearly tripled from those of the previous two years. In the 1971–73 period, trade balances were increasing and the government took actions such as authorizing Samurai bonds (foreign government bonds sold in Japan) to boost outflows.

Then, in 1974–75, average outflows fell by nearly one half. Government actions, such as suspending Samurai bond issues, slowed outflows and propped the yen.

Outflows quadrupled in 1976–78 as the government relaxed many controls. During that period, the yen was under considerable upward pressure from huge trade surpluses, and larger outflows helped slow yen appreciation.

Outflows rose in 1979–80 despite the government's apparent desire to support the yen. The government wasn't as aggressive in curtailing banks' overseas lending and Samurai bond issues as in 1974–75 because authorities felt too much restraint would destroy banks' and security houses' reputations for dependability. Instead, the government depended much more on capital inflows to offset the deterioration in the trade balance caused by higher oil prices (refer back to Table 4).

Summary of the effects of capital controls

Japan's net capital flows (Table 7), as well as individual capital movements discussed earlier, fluctuated widely during the 1970s. That in itself is not unusual—U.S. capital inflows nearly doubled in 1981. But what is unique about Japan's capital flows is that they are not market determined. The large swings shown in Table 7 resulted primarily from changes in government capital policy. In most years, the government encouraged, and realized, net outflows which helped keep the yen undervalued.

TABLE 7.—JAPANESE CAPITAL AND TRADE STATISTICS

	Net private capital flows (billions U.S. dollars) [1]	Trade balance (billions U.S. dollars)	Percent yen undervalued	Japan's share of industrial country exports 1 year later (percent)
1972	−4.3	8.9	−36.6	9.2
1973	−3.4	3.7	−25.0	10.4
1974	6.0	1.4	−22.6	9.8
1975	0.6	4.9	−24.9	10.6
1976	−0.1	9.8	−24.2	11.3
1977	−5.1	17.1	−16.4	11.4
1978	−7.8	25.3	4.3	9.7
1979	−6.8	1.8	−5.5	10.5
1980	18.8	2.1	−13.7	12.4

[1] A negative means a net capital outflow.

Source: IMF, International Financial Statistics; Economics G.O. estimates.

In the years when net inflows were experienced (1974–75 and 1980), the yen's undervaluation held steady or increased. Had the government not encouraged capital inflows, the yen would have been so undervalued that other governments would probably have reacted. As it was, the yen was undervalued enough to allow Japanese exporters to increase their share of industrial country trade (column 4, Table 7).

The yen moved closest to parity in 1978—a year in which the government was clearly trying to boost capital outflows. But Japan's trade balance was so large that the yen would have been significantly overvalued without increased capital outflows. In Japan's best trading year, the yen barely exceeded its estimated equilibrium.

Changes in reserves

R. M. Stern, in his book, "The Balance of Payments," suggests that changes in a country's international reserves over time provide a reasonably objective measurement of a payments disequilibrium. Japan increased official reserves nine of the last 12 years (Table 8)—strong evidence that the government persistently kept the yen undervalued.

A good part of those changes in reserves was probably just accumulation of earnings. But the impact on the balance of payments was the same because repatriation of earnings would give rise to demand for yen. So by accumulating earnings as reserves, the government was offsetting a yen-strengthening activity—and contributing to keep the yen undervalued.

TABLE 8.—JAPAN'S OFFICIAL RESERVES

[Billions of U.S. dollars]

	Foreign exchange reserves	Changes in reserves
1970	$3.2	$0.6
1971	13.8	10.6
1972	16.5	2.7
1973	10.2	−6.3
1974	11.3	1.1
1975	10.6	−0.7
1976	13.9	3.3
1977	20.1	6.2
1978	28.9	8.8
1979	16.4	−12.5
1980	21.6	5.2
1981	24.7	3.1

Source: IMF, International Financial Statistics.

Japan accumulated reserves in 1981, indicating that the government helped prevent some appreciation of the yen. That action shows the yen's current undervaluation cannot be blamed solely on high U.S. interest rates—a point we made in the introduction.

The government's reserve policy also shifts exchange risk away from exporters. As an example, after the "Nixon Shock" of 1971, the Bank of Japan added $7.5 billion to reserves so that trading companies could reduce their dollar exposure without taking an exchange loss. So, exporters don't have much incentive to price in yen, limiting its use as a trading currency.

Is the yen unstable?

Others point to the yen's wild fluctuations through the 1970s as proof the government doesn't control the yen's value. Certainly the yen was very volatile (Table 9) but we don't accept that as proof the yen's value isn't manipulated.

Comparison with the German mark is interesting because both Germany's and Japan's balance of payments are similar. Both import a lot of oil, both run merchandise trade surpluses and service deficits, and both accumulate reserves countercyclically. The main difference is that Germany is more willing to allow freer movement of capital. Despite the many similarities, the mark was more stable than the yen.

TABLE 9.—YEARLY AVERAGE EXCHANGE RATES

[Units national currency per U.S. dollar]

	Japanese yen	German mark
1971	349.3	3.49
1972	303.2	3.19
1973	272.7	2.67
1974	292.1	2.59

TABLE 9.—YEARLY AVERAGE EXCHANGE RATES—Continued

[Units national currency per U.S. dollar]

	Japanese yen	German mark
1975	296.8	2.46
1976	296.6	2.52
1977	268.5	2.32
1978	210.4	2.01
1979	219.1	1.83
1980	226.8	1.82
Variability about the long-term trend (percent) [1]	8.4	0.6

[1] Standard deviation about a linear trend as a percent of the average. The higher the percent, the more variable is the exchange rate.
Source: IMF International Financial Statistics.

We feel the Japanese Government's frequent reversals on capital policies create that instability. As an example, the government encouraged capital outflows in 1977-78 to offset the ballooning trade surplus. The 1979 oil shock cut the surplus from $25 billion in 1978 to $1.8 billion in 1979. But capital outflows increased in 1979, further weakening the yen. Had the government not pushed capital outflows so actively in 1978, the yen would not have depreciated so much in 1979.

WHAT IF THE YEN WERE AN INTERNATIONAL CURRENCY?

Lately, considerable attention has centered on making the yen an international currency—one which could be used freely outside Japan as a trading and reserve currency. The central theme of those discussions is that an international yen would be a more realistically valued currency.

We agree with that. The Japanese Government would need to end most capital controls to internationalize the yen. Even more importantly, it would not be able to repeatedly change controls to satisfy trade objectives. Without those controls demand for yen would increase.

One way is that more governments would hold yen as a reserve currency. Desirable qualities of a reserve currency country are that it (1) be politically stable, (2) have a strong, developed economy, (3) have a low rate of inflation, and (4) be heavily involved in international trade. Japan meets all those criteria. Currently, only 5 percent of world reserves are held in yen (compared to 12 percent for the German mark). If yen assets were more available, that figure would surely rise.

Another way is that yen would be used more as a trading currency; that is, more countries would price exports and pay for imports in yen instead of dollars. (Yen-based trade would even include some non-Japanese trade.) If that happened, traders would need to carry yen working balances, further increasing yen demand.

The most obvious place for more yen-based trade is in the Far East. Already, Japan is the dominant country, accounting for one-fourth of all trade and over half of all direct investment. With easier yen access, many countries would switch to yen billing to avoid disruptions caused by dollar fluctuations.

Relaxing controls would also allow more nonresident investment in Japan. In particular, we think share equity purchases would rise substantially because Japan's major companies are attractive investments.

Finally, internationalizing the yen would expose domestic capital markets to the rest of the world. That would force domestic interest rates, after adjusting for expectations about exchange rate movements, to a parity with other countries' rates. Higher interest rates would discourage some business investment and reduce net capital outflows.

Even if the yen were internationalized the Japanese Government could still add to reserves to keep the yen undervalued. But without controls on inflows, "hot money" would quickly move into Japan if the yen were noticeably undervalued. Inflows would be so large that the cost of adding them to reserves would be prohibitive. Possibly the government could keep the yen undervalued 5 percent—way below the 20 percent undervaluation of the 1970s.

PROSPECTS FOR INTERNATIONALIZING THE YEN

The Japanese Government publicly accepted the goal of making the yen an international currency. In December 1980, it amended foreign exchange and investment laws to freely permit international transactions unless specifically prohibited. Previously, all international transactions were forbidden unless specifically permitted. But we don't think the changes will be that significant:

1. The government can still prevent foreign majority ownership of a company, ownership of more than 10 percent of a company's stock by a single foreigner, or more than 25 percent foreign equity in sensitive companies. These will probably continue to suppress equity demand.

2. The government can still impose capital controls to prevent drastic exchange rate fluctuations or balance-of-payments difficulties. Those describe conditions which caused the government to change rules repeatedly during the 1970s.

3. The government uses "window guidance" or suggestions to influence private behavior. Government warnings and official monitoring may just replace formal regulations.

So the new laws will probably leave the yen a long way from being an international currency. Past experiences suggest that the Japanese Government will delay wider use of the yen as much as possible. It will ease controls only in the face of considerable political pressure, and then only enough to quiet criticisms. In fact, the executive director of the Bank of Japan said, ". . . we are not always or not necessarily happy with the larger holding of yen balances by nonresidents because such a development will make domestic monetary control more complicated and more difficult . . ." (April 8, 1981).

Economic forces requiring a freer yen are few and they operate slowly. One we've already discussed—the wider use of yen in trade and reserves. While that use is still small, it is up from virtually nothing in 1970. Japan's increasing exports would gradually require more yen trading.

Another is that Japan is a net capital exporter. As its overseas investment stock increased, interest and dividends earned (service exports) also increased. From 1977–80, Japan's overseas investments earned more than was paid on nonresident investments in Japan. This surplus should increase over time and will put upward pressure on the yen. Eventually, the government will have trouble offsetting investment income inflows.

Political actions are also limited. The International Monetary Fund authorizes periodic reviews of exchange practices under Article IV, but that provision hasn't provided an adequate forum for one country to bring action against another for gaining a trade advantage with exchange rates. A recent article by the Director of the Research Department of the Fund set forth the same criteria as developed in this paper for determining when a country's exchange rate is persistently out of adjustment. Japan has consistently met those criteria, yet no action has been taken.

Bilateral or even multilateral discussions would probably be futile. We could point out any number of reasons why the Japanese Government should ease capital controls—reciprocity in investment, Japan's huge trade surpluses could start trade wars, and Japanese companies are competitive enough that they don't need an undervalued yen. But those arguments probably wouldn't produce much change.

Moreover, recent trade discussions show that the Japanese are less willing to compromise. They are increasingly placing the blame for trade imbalances on the West. In fact, Business International just reported that the Japanese Foreign Ministry is instructing all 14 consuls general in the United States to start a long-term multimillion-dollar educational program. One theme is that U.S. investment abroad displaces U.S. production for export and leads to more imports—similar to Hartke-Burke arguments of the early 1970s.

The only way other countries can change Japan's policies is to exert pressure which the Japanese can't side step. We feel the only option is for the United States and European Community countries to strongly encourage the Japanese to allow the yen to be used more freely by its own citizens and by world traders, without intervention or resorting to the use of exchange control measures. That would allow industries in all industrial countries to operate under the same conditions and avoid distortions.

If industrial countries jointly and quickly urge such changes, Japan would have few alternatives left to protect the yen. They would have to respond with a proper valuation for the yen, and there would be much more likelihood that its value would approach its perceived equilibrium.

Mr. **Elder**. Those kinds of variables, such as exchange rates and export financing are factors that ironcutters like us cannot deal with.

Mr. **Bailey**. You just have to understand something, and our American businessmen have to understand something, and our

American politicians. You are not competing in terms of just some company who is out there trying to sell in the Third World. That is not the case. You are going to be deliberately looked at in terms of the export value of what you sell, and you are going to be deliberately undersold, you are going to be facing situations—I confronted this situation first dealing with utilities. It had to do with superior technology sales from the United States to Indonesia on turbine blade technology. In some cases it is true the Japanese technology is superior, particularly for geothermal applications. This was not the situation. The financing deal was a sweetheart deal setup at below domestic Japanese rates. It was Hitachi Corp., and was nothing more than an attempt to simply capture a market with a monopolistic national practice.

Now, that is what I have been trying to preach in these hearings, that we need to wake up to, because the world cannot survive that way. I compliment you because it is a case where somebody can say you build the best, but they do not buy because you are the best. You have to go to a cheaper line. Your quality falls, investor confidence falls, it does not pay to reinvest, to put the money into the technology, you cannot compete and you die. And then an American investor or international investor says I want to compete in that market, and they look at the Japanese market and say, "I got to be nuts."

Like investing in synfuels, when somebody says 10 bucks a barrel, you are not going to synthesize at $29 to $30 a barrel or $40 or $45 a barrel because there is no security, so you stay away from investing in that area. I admire and respect you, but I hope you learn what you are up against, because I know darn well what your technology is like. I am impressed with the kind of machinery—you have rebuilt this world. More credit ought to be given for the technology you have given in restructuring and rebuilding the world since the Second World War than normally is. Absolutely terrific job. I hope you continue to exist. I am proud of you.

Mr. ELDER. Thank you.

Mr. BAILEY. Thank you very much, Mr. Chairman.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. Thank you for excellent testimony. I have no questions.

Chairman GIBBONS. Thank you.

Our last witness is from the American Heritage Foundation, Ms. Catherine England. The Heritage Foundation has completed a study on H.R. 5133, and she wants to discuss the study. Let me say I have had an opportunity to read the study. I think it is very well reasoned.

STATEMENT OF CATHERINE ENGLAND, POLICY ANALYST, HERITAGE FOUNDATION

Ms. ENGLAND. Thank you. I am Catherine England, a policy analyst at the Heritage Foundation. The comments I make today are mine, and do not necessarily represent the views of anybody at the Heritage Foundation.

Chairman GIBBONS. At the conclusion of your remarks I would like to put the issue bulletin in the record in its entirety, because it is very well done.

Ms. ENGLAND. No one would deny that the automobile industry is having problems. We are all familiar with the numbers concerning lost sales and autoworkers unemployed. The question facing this committee today is: What is the best way to begin to solve some of these problems?

Domestic content laws have been proposed as a solution. Proponents hope that by requiring that automobiles sold in America be produced at least to some extent in this country, employment gains will be made and the industry will be brought out of its current slump.

Careful analysis of the bill seems to indicate otherwise. Undoubtedly, under domestic content laws, more cars would be produced in the United States. Before accepting this as an unmitigated good, however, we have to examine the costs that would be associated with this increased production.

Immediately, the bill would cost thousands of jobs. The Department of Transportation estimates that a reduction in imports of the magnitude envisioned by this bill would endanger the jobs of over 90,000 workers in and around our Nation's ports. The American International Automobile Dealers Association predicts as many as 80,000 workers will be unemployed by the forced shutdown of import dealerships. There are also import-related jobs in advertising, trucking, and the repair and maintenance of foreign automobiles. These jobs would all represent a cost of this legislation.

Then there are the job losses that may take longer to show themselves. Even if we ignore the possibility of retaliatory measures taken by the Japanese, jobs in export industries would be threatened. Significantly reducing imports means that fewer dollars flow overseas. Simply put, consumers in foreign markets have fewer dollars to spend on American goods abroad. Fewer dollars overseas means the U.S. currency becomes even stronger when compared with other currencies. This leads to a relative increase in price of American goods abroad and a reduction in the price of imports in this country. Thus, demand for American goods overseas falls, reducing employment opportunities here, and demand for foreign goods in this country increases, again reducing employment opportunities.

Gains that may be made in the auto industry, then, may very well be offset by the adverse effects in other industries.

The second issue is the impact of such a bill on consumers. Reducing the number of automobiles brought into this country each year from 2.3 million to 700,000 in the short period of time contemplated by the bill would represent a significant reduction in the number of cars for sale. Even if the Japanese decided to make the kind of massive investments that would be required to meet local content laws, a questionable assumption in itself, they would not be able to start full-scale production by 1984. Neither could the American producers gear up to fill the shortfall in automobiles. The number of automobiles available would be reduced substantially. Significant price increases could not help but be the result.

This seems to be a very dangerous time to significantly raise the price of automobiles. Americans are already driving the oldest automobiles in our history. The average car on the road today is 7 years old, while the norm in the past has been closer to 5½ years. As a group, Americans are taking a serious look at the need for two cars within a family, or in some urban areas, at the need for a car at all. Significantly increasing the price of cars at this time could lead to a much larger than expected adjustment away from the purchase of automobiles. Furthermore, raising the price of cars might cause even more people to learn to maintain their automobiles properly. Everyone will want to get 100,000 miles out of their cars before they buy a new one. Forcing people to learn to take care of their present cars coupled with a move toward owning fewer cars means a reduced demand that might never fully recover.

But prices would not only increase because of a shortage of automobiles. The costs of American manufacturers would also undoubtedly rise. U.S. producers are now emphasizing the production of a world car. They have set up plants overseas for a number of reasons. Among them are admittedly the domestic content laws of the lesser developed countries, but the U.S. car companies have also increased their overseas production because it is less costly. Forcing a movement of these production facilities back to the United States cannot help but increase the cost of producing an American automobile. It also places a significant strain on the capital resources of American producers—financial capital that is already, as we all know, in short supply.

In addition to forcing American producers to build in the United States at a higher cost, domestic content laws would mean American manufacturers would send their automobiles overseas to compete in the face of a relatively strong U.S. dollar. We have already referred to that. Thus, U.S. producers would have higher than average prices as a result of both a cost disadvantage and an exchange disadvantage. This almost guarantees their elimination as a force to be reckoned with in the world automobile market. This is an important consideration for the long-term viability of the U.S. auto manufacturer.

The demand for cars in the United States will not grow significantly in the future even under the best of conditions. Incomes in this country have been at high levels for long enough to insure that just about everyone who wants a car has one. For the automobile industry to experience growth in the future, it must be able to enter those markets where income is just now reaching the levels conducive to widespread automobile ownership. They must be able to effectively compete overseas. The short-term gains expected by the supporters of this bill may very well be at the expense of the long-term health and growth of the industry.

The proposed domestic content law also violates existing international agreements to which the United States is a party. The GATT agreements preclude attempts to protect a nation's industry through quotas or content requirements, and forbids the favored status given Canada in the bill. Under GATT those nations harmed by such a law could ask for compensation in the form of concessions in their competition with other industries. Trade barriers might have to be lowered for other imported goods, for example. Thus, domestic content legislation for automobiles threatens other industries dependent on exports in even another way.

Finally, should Congress pass a domestic content law for automobiles, it must expect that other industries will soon be knocking at the door asking for similar protection. This will be particularly true as those industries now facing foreign competition find themselves at a disadvantage as the U.S. dollar strengthens abroad. If Congress gives credence to the arguments brought forward in support of domestic content requirements for automobiles, how can they fail to listen when the same arguments are presented by another industry. The situation can hardly fail to deteriorate back to the early days of the Depression when country after country set up protective tariffs in the name of saving its own industries.

No one really gains from this bill. Consumers are certainly hurt as they see the price of automobiles rise even further and their choices are reduced. The jobs of individuals in a number of industries will undoubtedly be threatened. American automobile manufacturers will be hurt in their attempt to produce a car that can compete on the world market. Even autoworkers will be hurt in the long run. To the extent that they reduce the industry's ability to expand in the future, they threaten their own security.

I have a great deal of faith in the American entrepreneur. I think the American automobile manufacturers have made great strides in producing a quality small car in the 10 years since the demand for fuel-efficient automobiles was thrust upon them almost overnight. I expect that the American manufacturers will be the great winners in the surge of demand for automobiles that is bound to occur as the economy recovers from the recession and interest rates begin to fall now that inflation is under control.

The domestic content bill is a dangerous short-term solution. The existence of net gains even in the short run is not assured. Certainly, the long-term disadvantages for the economy as a whole are overwhelming. There is always a hefty price to pay when government erects obstacles in the marketplace. A domestic content law would be an enormous obstacle whose net effects for the economy would be higher prices, reduced employment opportunities, and less choice for consumers.

Thank you again for this opportunity. I will be happy to respond to any questions.

Chairman **Gibbons**. You have covered the subject so well I have no questions. I think you have done an excellent job, and without objection, we will place the copy of the Issue Bulletin in the record at this point.

[The information follows:]

[From the Issue Bulletin, Heritage Foundation, Aug. 24, 1982]

DOMESTIC CONTENT LAWS: WILL THEY SAVE THE AUTO INDUSTRY?

(By Catherine England, Policy Analyst)

INTRODUCTION

"Made in America." It is a proud, well-respected label. But should laws require that goods be made in the U.S.? This is the purpose of the so-called domestic or local content requirements. They are designed to force manufacturers selling in other countries to conduct at least part of this production there as well. These laws are most common in developing nations seeking to generate employment opportunities for their populace while building the base for a future domestic industry. they seem embarrassingly out of place in a developed, highly technological nation. Yet, this is precisely what may happen in the U.S.

A domestic content bill for automobile manufacturers is now before Congress. It has over 200 co-sponsors in the House and seventeen in the Senate. Primary supporters of the legislation are the United Auto Workers and automobile parts suppliers. Proponents tout the legislation as just the medicine to cure the American automobile industry's ills and put thousands of unemployed autoworkers back to work. Opponents fear the legislation could do more harm than good.

General support for domestic content laws rests on two basic tenets. Proponents argue that the manufacture of some products, in this case automobiles, is so important to the economy that whatever is necessary must be done to ensure the health of that industry. Backers of domestic content laws further maintain that producers with substantial sales in a foreign country have a responsibility to generate employment and economic activity there.[1]

These arguments are not universally accepted. They are opposed, for example, by free market advocates who assert that the maximum benefits to a society are achieved through open trade where countries specialize and exchange goods freely. Even those wo believe the U.S. should not completely open its borders, as long as other countries do not engage in free trade, seriously question domestic content in general and this law in particular.

The debate falls into five broad areas:

I. Those supporting the bill believe that the legislation would prompt considerable investment by foreign manufacturers in the U.S. Opponents disagree, claiming that instead producers of imports will reduce their sales to levels at which domestic content requirements do not apply.

II. The impact of the requirements on U.S. automakers is in dispute. Proponents claim the bill would put American manufacturers on a stronger footing in meeting competition from overseas. Those fighting the bills believe domestic content requirements actually will harm American automobile producers, severely damaging their ability to compete in a worldwide market.

III. There is disagreement over how consumers will fare under domestic content laws. Proponents predict neither dramatic price increases nor significantly reduced selection. Those opposing the bill feel that, because foreign manufacturers are unlikely to start operations in the U.S., the costs to American consumers will be substantial.

IV. Supporters maintain the chances of retaliation by other countries are slim. Opponents fear a major trade was may result.

V. The impact on U.S. jobs is being debated. Employment will unquestionably be created in the domestic automobile industry, but there is disagreement about how much. Meanwhile, opponents argue jobs will be lost in other export related American industries and that losses may actually exceed total employment gains.

Clearly, the potential impact of domestic content requirements deserves a closer look.

BACKGROUND

That the U.S. automobile industry is in a depressed state is not disputed. Sales of new U.S. automobiles and light trucks have fallen dramatically, resulting in extensive unemployment among autoworkers. Douglas Fraser, President of the United Auto Workers estimates that 250,000 workers are now on indefinite layoff.[2] Faced with this large number of unemployed members and the apparently desperate state of the industry generally, the UAW is heavily supporting the domestic content bills—H.R. 5133 and S. 2300.

Proponents of the bills point to other countries which protect their auto manufacturers. In testimony before Congress this March, Fraser and Howard Samuel, President of the Industrial Union Department, AFL-CIO, told of the extent of market interference by various other governments.

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[1] Dick K. Nato, "Local Content Laws and Automobile Imports: Arguments Pro and Con," Congressional Research Service Report No. 81-191 E, August 20, 1981, p. 1.

[2] Statement of Douglas A. Fraser, President, United Auto Workers, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 2.

In the last 20 years, they explained, the governments of Japan, Germany, France, Italy, and the United Kingdom all intervened at critical stages to save their national automobile producers from seeming destruction.[3] Italy, for example, has limited imports of Japanese autos to 2,000 units annually. France restricts Japanese imports to 3 percent of its domestic market, while Great Britain allows no more than 10 percent of total automobile sales to go to the Japanese.[4] Furthermore, over thirty countries now impose domestic content requirements on their automobile industries—among them Argentina, Brazil, Mexico, and South Korea.[5]

Supporters of the legislation also point out that no other manufacturing industry in the U.S. can match the auto manufacturers in terms of size or impact on the rest of the economy. Samuel claims that one of every five American jobs is linked to the auto industry.[6] The continuing depressed state of the industry is having ripple effects and harming other U.S. industries—particularly automobile parts suppliers.

It is further argued that action taken now can influence foreign automakers' decisions about where to buy parts and components as well as where to build new plants. UAW spokesmen note that this has occurred in other countries. Even though the automobile markets of Europe, Latin America, and other Asian nations are much smaller than that of the U.S., Japanese firms are making investment commitments in these parts of the world far in excess of those that have been made in this country.[7]

Proponents make two final arguments. They claim automakers have something of a moral obligation to generate employment in those countries in which they have substantial sales. Further, the free market approach pursued until now has not solved the unemployment problems of the American automobile industry. As a result, conclude these spokesmen, domestic content laws are needed.

H.R. 5133 AND S. 2300

Introduced by Representatives Richard Ottinger (D-NY) and John Dingell (D-MI) in the House, H.R. 5133 is entitled the "Fair Practices in Automotive Products Act." As of early August, the bill had 218 co-sponsors. The companion piece of legislation in the Senate, S. 2300, was introduced by Wendell Ford (D-KY) and had seventeen co-sponsors.

The bills have [illegible] major sections: Title I—Domestic Content Requirements for Motor Vehicles and [illegible]—Unfair and Deceptive Practices of Vehicle Manufacturers. Title II would [illegible] an automobile producer to determine when domestically produced replacement [illegible] satisfy reasonable standards for use in his automobiles and to supply notice [illegible] dealers that such parts may be used. While potential problems with this [illegible]st, debate has centered on the first section of the bill dealing with local [illegible]

If they became [illegible] and S. 2300 would require that by 1983 the overall fleet average of [illegible] light trucks (i.e., those weighing less than 10,000 pounds) sold in [illegible] a fixed percentage of U.S. labor and U.S. and Canadian parts (or North American content). Following a phase-in period, by model year 1985, producers selling between 100,000 and 150,000 vehicles in the U.S. would need a fleet average of 25 percent North American content. Sales of between 150,000 and 200,000 annually would require 50 percent domestic content. Manufacturers selling from 200,000 to 500,000 vehicles would be required to maintain 75 percent local content, while sales over 500,000 units would carry a 90 percent North American content requirement. A firm failing to meet the requirements would be forced to reduce U.S. sales by 25 percent during the following model year.

The standards set by this legislation are much more stringent than those employed by the Environmental Protection and Conservation Act (EPCA) for determining whether fuel efficiency standards are met. EPCA standards count not only labor and parts toward domestic content (as H.R. 5133 and S. 2300 do), but some overhead items as well. For example, expenses incurred in marketing automobiles in the U.S. may be counted as part of local content as well as the servicing arm of the producer.

The stated goal of those supporting the legislation is to encourage investment by foreign manufacturers in the U.S.—particularly the Japanese. Thus, it is argued, jobs will be created for American workers and investment dollars now flowing overseas to U.S. automobile manufacturers' subsidiaries will be spent domestically.

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[3] Ibid., p. 9.

[4] Statement of Howard D. Samuel, President, Industrial Union Department, AFL–CIO and Chairman, Coalition of Automotive Component and Supply Workers, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 3.

[5] Fraser, op. cit., p. 8.

[6] Samuel, op. cit., p. 1.

[7] Fraser, op. cit., p. 9.

IMPACT ON FOREIGN MANUFACTURERS

Table I lists the number of foreign cars and light trucks sold in the U.S. in 1981. Based on this, seven foreign auto producers would be directly affected by the legislation. To maintain their 1981 level of sales, Toyota and Datsun would be required to meet a 90 percent local content requirement. Honda, Volkswagen, and Mazda would have to raise their fleet averages to 75 percent domestic content. Subaru would have to meet a 50 percent requirement, and 25 percent of the Mitsubishi fleet (marketed in this country by Chrysler) would have to be produced domestically. Of the seven producers, six are Japanese. Only Volkswagen is European based.

TABLE I.—*Cars and light trucks*

Manufacturer:	
Toyota	713,981
Nissan (Datsun)	580,139
Honda	370,705
Volkswagen (including those produced in the United States and imports of Volkswagens, Audis, and Porsches)	340,555
Toyo Kogyo/Mazda	246,831
Subaru	152,062
Mitsubishi	110,940
Volvo	64,447
Mercedes Benz	67,113
BMW	41,761
Fiat (includes Lancia)	33,253
Jaguar/Rover/Triumph	18,956
Peugeot	16,937
Saab	14,613

Source: Dick K. Nanto, "Automobile Domestic Content Requirements," Congressional Research Service Issue Brief No. IB 82056, May 18, 1982, p. 9.

The UAW and others supporting domestic content legislation believe the foreign manufacturers will attempt to maintain their current level of sales in the U.S. and, thus, start building cars in this country, creating extensive employment opportunities for American workers. Others are not so sure. Potential roadblocks to foreign investment in this country are mentioned by several analysts.

A Congressional Research Service (CRS) report noted that the Japanese feel investment in the U.S. would raise costs and represent considerable risk. Japanese producers are leary of U.S. labor relations. The relationship between the Japanese auto manufacturers and their workers is much less adversarial than that of U.S. producers and the UAW. Furthermore, the Japanese feel their production costs would rise because of increased uncertainty about parts procurement—both from American and Japanese suppliers. This uncertainty would necessitate larger inventories of components and, hence, lead to higher carrying costs.[8]

Plant size may also cause problems. U.S. assembly plants must generally produce 150,000 to 200,000 units to attain sufficient scale to operate at lowest cost.[9] In addition, these plants usually produce one, at most two, models efficiently.[10] Thus, the larger Japanese manufacturers would be able to produce only a couple of models efficiently. But, even manufacturing their two top-selling models with 90 percent North American content would leave Toyota and Nissan well below a 75 percent local content level for their fleet.[11] Therefore, if foreign manufacturers were willing to make the kind of U.S. investment necessary to achieve efficient production as well as meet local content requirements, overcapacity in the U.S. automobile industry would result.[12]

Finally, there is a question of timing. In a letter to Representative John Dingell, the Federal Trade Commission suggested the phase-in period set by the bill may not be sufficient to allow serious consideration of extensive U.S. investment by the firms affected.[13]

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[8] Nanto, op. cit., p. 17.

[9] Dick K. Nanto, "Automobile Domestic Content Requirements," Congressional Research Service Issue Brief, No. IB82056, May 18, 1982, p. 6.

[10] Nanto, CRS Report, p. 19.

[11] *Ibid.*, p. 4.

[12] Charles P. Heeter, Jr., "The Arguments Against U.S. Domestic Content Rules for Automobiles," The Government Research Corporation, August 10, 1981, p. 8.

Many of the more specific problems with the legislation become apparent by looking at how Honda and Volkswagen of America would be affected if these bills became law.

Volkswagen of America has been praised by Douglas Fraser as an example of a firm with a proper commitment to investment in the U.S.[14] North American content of VW Rabbits produced in the U.S. is approaching 70 to 75 percent as measured by EPCA. Under the definition of the bill now before Congress, however, the content of U.S. produced Rabbits is in the range of 40 to 45 percent. Furthermore, because the domestic content bills place content requirements on the fleet rather than the model, Volkswagen is far from meeting a 75 percent local content requirement. Volkswagen produced 197,000 cars in this country in 1980, but to provide its dealers with a complete line of automobiles, 91,000 additional VWs were imported along with 50,000 Porsches and Audis.[15] To meet the requirements of H.R. 5133 and S. 2300, VW would have to cease importing all other Volkswagen models, Audis, and Porsches. This actually penalizes Volkswagen relative to manufacturers with no presence in the U.S. These other firms would still be able to import up to 100,000 vehicles annually.[16]

Honda is in an even less enviable position. Honda has plans to begin production in Ohio this fall. Full output of 150,000 units annually is expected to be reached by mid-1984; the plant is expected to provide 2,000 jobs.

To start producing in the U.S. as soon as possible, Honda plans to import many components. This will result in a relatively high Japanese content for the Hondas made in America. Thus, Honda would be unable to meet the requirements of the legislation even with its U.S. production—at least at first. Honda maintains, moreover, that it will actively seek local suppliers, but necessary lead time and product specifications make it difficult to bring U.S. suppliers on line more rapidly.[17]

Based on these considerations, many analysts of the potential effects on H.R. 5133 have concluded it is unlikely foreign manufacturers will rush to build production facilities in the U.S. In fact, most sources agree that local content requirements would actually discourage investment within the U.S. by reducing the flexibility of foreign manufacturers to use worldwide sourcing for components.[18]

IMPACT ON U.S. MANUFACTURERS

Arguing that increased imports are a primary cause of the high unemployment and low profitability of U.S. automakers, proponents of local content bills predict nothing but good for U.S. manufacturers. Supporters claim such laws would introduce a fairness now lacking in our auto-trade relationships with other countries by placing U.S. producers on a more equal footing with their foreign counterparts.[19] According to a Business Week editorial, a domestic content law would provide needed protection against Japanese imports while American manufacturers retool to produce small cars.[20] Without this legislation, it is argued, the U.S. "will continue to be a helpless victim of other countries' auto policies."[21]

Supporters envision other advantages from domestic content laws. Stating that "a local content requirement would cause a minimum of disruption in ordinary channels of trade," the Business Week editorial predicts increases in U.S. employment without eliminating the profits of Japanese firms or prohibiting U.S. consumers from buying the kinds of cars they want.[22]

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[13] Letter from Carol M. Thomas, Secretary, Federal Trade Commission, to Representative John Dingell, p. 2.

[14] Fraser, op. cit., pp. 8–9.

[15] "Domestic Content Legislation," Toyota Corporation, May 7, 1982, p. 3.

[16] Nanto, CRS Issue Brief, p. 6.

[17] Statement of American Honda Motor Company, Inc. on H.R. 5133, "Fair Practices in Automotive Products Act," before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee.

[18] See, for example, Heeter, pp. 8–9; "Domestic Content Laws: Rx for a Permanently Non-Competitive Industry," American International Automobile Dealers Association, p. 9; or Letter from Darrell M. Trent, Acting Secretary of Transportation to Representative James T. Broyhill, p. 1.

[19] Fraser, op. cit., p. 6.

[20] "A Better Way to Handle Auto Imports," Business Week, April 13, 1981.

[21] Fraser, op. cit., p. 10.

[22] "A Better Way to Handle Auto Imports."

The UAW adds that a domestic content law would encourage more competition among manufacturers by bringing more automakers into the U.S. Business Week foresees intense competition among U.S. suppliers for the Japanese firms' parts business. Thus, it is argued, incompetent, high-cost firms would not be protected under these laws as they would with tariffs or import restrictions.[23] In addition, U.S. producers are expected to continue to be disciplined by the designs and emerging innovations of foreign based producers.[24]

Finally, proponents argue that the fear that producers will be unable to achieve plant size and output necessary to reach economies of scale is unfounded. H.R. 5133 and S. 2300 allow producers to receive credit for parts of vehicles exported to offset imported items. Thus, it is claimed, sufficient size for efficient production will be possible.[25]

Many question the rosy picture painted by the bill's supporters. In the first place, many analysts do not place the primary blame for the recent poor performance of the auto industry on imports. Most notably, the U.S. International Trade Commission (ITC) studied the auto industry in 1980. The ITC concluded that imports represented only a small part of the industry's problem. Higher gasoline prices and the resulting demand for smaller, more fuel efficient cars allowed the Japanese to gain a temporary advantage in the U.S. Domestic manufacturers were, at the time, unable to meet the demand for compact cars. This gap, however, is being closed rapidly.[26] U.S. automakers have begun paying unprecedented attention to quality and productivity. As a result, domestically produced small cars have gained more from recent shifts in consumption patterns than foreign cars have. Explains one analyst: "The Japanese themselves are concerned about the coming competition. . . . Silhouetted against two-ton behemoths, the Japanese models look clever and economical; compared with a new generation of space-efficient front-wheel-drive cars, they are cramped and anachronistic."[27]

The ITC concluded that the recession and continued high interest rates combined with falling real discretionary income for American households and consumer pessimism have had the most significant impact in reducing U.S. auto sales and keeping them low.[28] Furthermore, the rapidly rising cost of automobiles (or "stocker shock") in 1979 and 1980 was cited as a factor in the overall decline of car sales.[29]

Many observers feel none of the U.S. auto producers could meet the requirements of the content legislation as it is now written. This is in part due to the very narrow definition of North American content in H.R. 5133 and S. 2300, but is also the result of increasing reliance by American manufacturers on worldwide sources. Douglas Fraser admits that "[M]any of the steps the U.S.-based auto multinationals will be taking to improve their competitive positions could cause further widespread unemployment and continued erosion of the nation's industrial base."[30] (Emphasis in original.) While the U.S. automobile industry has made great strides to become internationally competitive, many observers fear domestic content laws would greatly inhibit, if not reverse, this welcome development.

Confronted with the enormous cost of developing a smaller, more fuel-efficient car, the need to conserve capital resources, and the lower production costs in many foreign countries, American producers have sought more foreign sources for components for U.S.-made autos. Foreign firms, after all, have the experience in producing parts for smaller vehicles. Ford, Chrysler, and American Motors, in particular, save considerable time and expense by purchasing small engines and transmissions abroad rather than developing and producing them domestically. In fact, one industry analyst has questioned the ability of Ford and Chrysler to tool up and build the components they now import should the domestic content legislation become law. General Motors is also taking advantage of foreign expertise, buying 400,000 diesel engines from Isuzu. GM probably has the financial resources to produce the engines, but feels it lacks the engineering time and talent to accomplish the task quickly enough.[31]

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[23] Ibid.

[24] Fraser, op. cit., p. 8.

[25] Ibid., p. 6.

[26] Heeter, op cit., p. 5.

[27] Ibid., p. 6.

[28] "Domestic Content Laws: Rx for a Permanently Non-Competitive Industry," p. 7.

[29] Statement of Ambassador David. R. MacDnald, Deputy U.S. Trade Representative, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 2.

[30] Fraser, op. cit., p. 15.

[31] Nanto, CRS Report, p. 15.

Furthermore, Fraser's allegation that U.S. auto producers are planning an even greater reliance on foreign sources is well-founded. Some industry observers predict that U.S. manufacturers will import up to 25 percent of their parts by 1985 and 35 percent by 1990.[32] This may be necessary if American producers are to minimize costs and compete on a worldwide basis.

The ability of automakers to compete in an international market will become more crucial in the future. In the first place, the U.S. market for automobiles in a mature one. Population size is relatively stable and income levels are such that most people who want a car already own one. Manufacturers, therefore, cannot expect much more growth in the U.S. market.

On the other hand, incomes in other countries are still rising. The average household income in Europe and Japan has caught up to that in the U.S. only recently. The markets with growth potential, thus, are overseas. With American gasoline prices now at world levels, consumers world wide are demanding cars of about the same size and design. As a result, U.S. automakers are interested in manufacturing cars that can be sold and produced in many markets. GM's J-cars, for example, are produced in nine countries.[33] Domestic content laws would severely harm the ability of American automobile manufacturers to compete in this international market.

First, U.S. firms are, unfortunately, required to invest abroad to meet the local content requirements of other nations. For these plants to achieve an efficient size, some of their output must be exported.[34] Stringent U.S. domestic content requirements would severely limit automakers' ability to achieve economies of scale in these plants.

Second, while some overseas investment is forced, some is clearly voluntary. The natural tendency of producers to minimize costs implies that forcing them to relocate these plants in the U.S. would increase their costs of production. GM, for example, is convinced that worldwide sourcing permits cost-effective, efficient production.[35]

Third, because of the need to relocate these plants in the U.S. or Canada, domestic content requirements would aggravate the demand for already scarce financial capital among U.S. firms.[36]

These considerations led the Wall Street Journal to conclude that local content requirements "would deliver a knock-out punch to GM's and Ford's 'world car' strategies of consolidating international production and gaining access to the highest quality, lowest cost engines and parts."[37]

Reduced flexibility to use foreign sources is not the only cost increase. The bookkeeping required for compliance with the law would be considerable. Unlike the case of emissions and safety certification, the local content of most vehicles could not be certified in the prototype stage. High volume models are manufactured at different plants throughout the U.S. and often have different sources for the same equipment. In addition, suppliers are sometimes changed during the model year.[38] Extensive record keeping by the manufacturers would have to be coupled with detailed reports from parts suppliers to avoid "laundering" of foreign produced parts through U.S. firms.[39]

If foreign manufacturers decide to reduce their sales in this country rather than make the necessary investment here, competition will be contracted significantly. Incentives for continued investment and productivity advances would fade. The Detroit News worries that "local content legislation [would] merely set in concrete incentives for inefficiency."[40] A significant reduction in competition from foreign firms, moreover, would raise serious questions about the degree of competitiveness among American automakers. Antitrust investigations would follow.

No one argues that a domestic content law would increase profits for U.S. auto parts suppliers. But, if the law reduced the ability of American auto manufacturers to compete internationally, greater profitability for suppliers might be offset by reduced profitability among automakers.

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[32] Ibid., p. 7.
[33] Ibid., p. 6.
[34] Ibid., p. 15.
[35] Ibid., p. 16.
[36] FTC Letter, p. 2.
[37] "Detroit, Argentina," Wall Street Journal, April 28, 1982.
[38] FTC Letter, p. 3.
[39] Nanto, CRS Report, p. 17.
[40] Detroit News editorial, March 3, 1982.

EFFECT ON CONSUMERS

The UAW and others supporting domestic content laws assume Japanese manufacturers will build plants in the U.S. in an effort to maintain current sales levels. Based on this assumption proponents believe the U.S. consumer will suffer neither significantly higher prices nor reduced selection. Fraser notes that Volkswagen faces no substantial cost disadvantage by producing in the U.S., and there is at least some evidence that the quality of Rabbits produced in this country exceeds that of the European produced cars.[41]

Supporters further argue that if automobile and light truck prices do rise slightly, it is only what is needed to restore profits and provide funds for capital investment.[42] Thus, the UAW and others behind the legislation claim content requirements will be equitable to consumers while ensuring that the money from automobile sales stays in the U.S. and benefits the American economy.[43]

Critics of the bill disagree with these rosy predictions. They note that while it may be true that VW faces no substantial cost differences between its U.S. and European plants, the same may not hold true for Japanese manufacturers. The inevitable increase in production costs caused by forced relocation will lead to higher automobile prices for the U.S. consumer.[44]

Because opponents of the content requirements believe foreign manufacturers will be unable or unwilling to make massive investments here, there will be fewer models from which to choose, and the shortages of various models will result in a "scarcity premium" driving up prices further.[45] The Department of Commerce has suggested that auto prices would rise by 10 percent or more.[46] A 1980 study by the Council of Economic Advisors estimated that limiting imports to 10 percent of the U.S. market would raise car prices from 13 to 17 percent.[47]

A Federal Trade Commission study examined the potential impact of reducing imports from 2.4 to 1.7 million annually—a less restrictive proposal than that mandated by the domestic content bills. The FTC report concluded that auto prices would increase between $527 and $838 per unit.[48] American International Automobile Dealers Association President Robert McElwaine predicts an even greater price hike. He sees consumers paying $850 to $3,000 more per automobile.[49]

These higher price tags mean that consumers will be paying a great deal to generate jobs for autoworkers. One study concluded that, for every job generated in the automobile industry at $20,000 per year, consumers would pay $80,000 to $90,000 in higher prices.[50] Other estimates are higher. Administration estimates predict that every job gained in the auto industry would cost the American economy $100,000.[51] Other studies claim that the cost to the economy of reemploying an autoworker under the current voluntary import restrictions ranges from $245,000 to $1,125,000. The proposed domestic content law could cost more.[52]

Ironically, autoworkers are among the highest paid American workers. Their wages are currently 28 percent above the average for all manufacturers.[53] With domestic content laws in effect, the average manufacturing employee earning $7 per hour would be required to subsidize autoworkers earning a $9.50 hourly wage.[54] In addition, with the removal of effective international competition to apply downward pressure on car prices, the UAW could continue to extract wages significantly in excess of the average for manufacturing.[55]

Supporters of the domestic content bills seem to assume that demand for automobiles will remain constant. This is unlikely. For one thing, if Americans are indeed suffering from "sticker shock," even a minor increase in prices will reinforce the trend to drive cars longer or buy used rather than new cars.[56] Thus, demand will be further reduced. In addition, the domestic content bills send a very negative message to the American consumer about the quality of U.S.-produced automobiles vis-a-vis foreign cars. It may be interpreted as an admission that American vehicles are unable to compete without the government's help in forcing their purchase.

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[41] Fraser, op. cit., p. 15.

[42] Nanto, CRS Issue Brief, p. 6.

[43] Samuel, op. cit., pp. 6–7.

[44] Nanto, CRS Report, p. 16.

[45] Ibid. p. 17.

[46] "Administration's Position on Local Content Legislation (H.R. 5133 and S. 2300)," June 18, 1982.

[47] Heeter, op. cit., p. 13.

[48] FTC letter, p. 2.

[49] Statement of Robert M. McElwaine, President, American International Automobile Dealers Association, June 9, 1982.

[50] Heeter, op. cit., p. 13.

[51] Summary of Administration's position, p. 1.

[52] "Domestic Content Laws: Rx for a Permanently Non-Competitive Industry," p. 6.

[53] Ibid.

[54] Heeter, op. cit., p. 13.

[55] Oral testimony by Robert M. McElwaine, President, AIADA, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 148.

IMPACT ON OTHER U.S. EXPORTERS

A domestic content law for the automobile industry could cause problems for other U.S. exporters. One of the most important considerations should be the effect of this legislation on international agreements now in force.

In testimony before Congress, Ambassador David R. MacDonald, Deputy U.S. Trade Representative, expressed concern that passage of the domestic content bills would violate the General Agreement on Tariffs and Trade (GATT). MacDonald noted that the establishment of specific minimum domestic content quotas directly conflicts with requirements in GATT Article III. This article states, in part, that no contracting party to GATT "shall establish or maintain any internal quantitative regulation . . . which requires, directly or indirectly, that any specified amount or proportion of any product . . . must be supplied from domestic sources." [57] In other words, domestic content laws are outlawed.

Ambassador MacDonald further noted in his testimony that the sanctions of the domestic content bills place strict limitations on the number of automobiles that may be imported by manufacturers who do not meet the local content requirements. This represents a violation of GATT's Article XI which prohibits the use of quotas to limit imports.[58]

Finally, the special consideration given Canada under the proposed legislation violates the most-favored-nation requirements of the Agreement. "[A]ny advantage, favor, privilege or immunity granted" to the products of one country must be accorded to similar products from all other contracting countries.[59]

GATT does contain methods through which these provisions can be circumvented—primarily Article XIX, the escape clause. This section allows a nation to suspend GATT obligations in whole or in part when imports seriously threaten domestic producers. Normally, a country invoking the escape clause is expected to compensate injured countries by granting trade concessions for other industries.[60]

Assuming the escape clause is invoked by the U.S. and agreed to by the other signatory nations, compensation may be sought—particularly by Japan. Certain industries are considered especially vulnerable. The computer, aircraft, telecommunications equipment, semi-conductor, and agricultural industries, for example, suddenly might face substantially increased competition abroad.[61]

For U.S. automakers, however, use of the escape clause would prove difficult. As the International Trade Commission concluded, imports are not substantially injuring U.S. automobile producers. U.S. automotive parts suppliers, moreover, have been consistently denied trade adjustment assistance because they have been unable to show that imports contribute significantly to worker layoffs and declines in sales.[62]

Given the difficulties of invoking the escape clause and the problems with agreement on compensatory trade adjustments for producers in nations harmed by the proposed domestic content laws, retaliation becomes a possibility. While expressing sympathy with the basic goal of encouraging investment by foreign manufacturers in the U.S., Senator John Heinz (R-PA) cautions: "The intrinsic problem with local content requirements is that they become a two-edged sword. If we have them, they are likely to be applied to our exports." [63] In fact, existing domestic content requirements abroad, and those that might arise in retaliation for a similar U.S. law, directly threaten the U.S. auto parts industry—one of the primary supporters of H.R. 5133 and S. 2300. The U.S. auto parts industry exports amounted to $3.9 billion in 1980 ($8.8 billion, if exports to Canada are included).[64]

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[56] Ibid., p. 146.

[57] MacDonald testimony, p. 6.

[58] Ibid., p. 7.

[59] Ibid.

[60] Nanto, CRS Report, p. 10.

[61] See, for example, Letter from Ambassador William E. Brock, U.S. Trade Representative to Representative James H. Scheuer, June 9, 1982; Heeter, op. cit., p. 11; or Summary of Administration's Position, p. 3.

[62] Nanto, CRS Report, pp. 10–11.

[63] Ibid., p. 14.

[64] "Detroit, Argentina."

Many of the bills' opponents fear that the present support for liberal worldwide trade is too fragile to withstand a major domestic content law in the U.S. Some analysts predict that such a move by the U.S. could set off a series of protective actions and reactions around the world.[65] This would represent a step back toward the disastrous "beggar-thy-neighbor" trade policies that contributed to the depression of the 1930s.

Not surprisingly, the UAW and others supporting the domestic content bills disagree with this assessment. Proponents deny that a trade war would result. They admit the proposed law is directed primarily at Japan, but point out that other countries are at least minimally affected. Supporters argue that trade problems with Japan have existed for some time. The Japanese government restricts imports of beef, citrus fruits, and cigarettes, for example, thus already violating a number of GATT provisions.[66] It is argued that Japan will be unwilling to seek compensation and open its government to countercharges by other signatory nations. Proponents, therefore, predict there will be no challenge of U.S. domestic content laws under GATT. In support of this assertion, Fraser notes that none of the domestic content requirements in thirty other countries has been challenged under GATT, nor have they been the cause of serious trade friction with Europe or Japan.[67]

Proponents argue finally that domestic content laws would give the U.S. trade negotiators leverage in bargaining to reduce barriers to U.S. exports in other countries.[68] Ironically, this push for a domestic content law closely followed a statement issued by Ambassador William Brock, U.S. Trade Representative, explicitly calling for a removal of foreign domestic content requirements. Opponents of the legislation fear the existence of U.S. requirements would undermine efforts by the U.S. delegation at upcoming trade talks to negotiate reduction of trade barriers. Ambassador Brock has expressed opposition to H.R. 5133 and S. 2300. In a letter to several Representatives, Brock called the proposed domestic content laws "blatantly inconsistent with our international commitments," and "the worst threat to the international trading system and our own prosperity to be put before Congress in a decade." He furthr notes that, if enacted, the legislation "would undermine the current drive by the United States to open foreign markets more fully to our products and would damage the international trading system to such an extent that less world trade and fewer jobs would be the eventual outcome." [69]

Even if retaliation does not develop to the extent expected by many, U.S. exports of other goods still may suffer. Artificially reducing imports means fewer dollars flow overseas, giving foreigners fewer dollars with which to buy U.S. goods. Given a system of floating exchange rates, the U.S. dollar then appreciates, making U.S. goods relatively more expensive overseas. Other things equal, imports thus would tend to increase and exports to decrease.[70]

In short, through retaliation, compensation, or the appreciation of the dollar, domestic content laws might well force non-automotive industries to pay for the UAW's content rules through intensified domestic competition from abroad or the loss of markets overseas.

And if the domestic content bills are passed for the automobile industry, representatives of other sectors soon will be making similar requests. Arguments similar to those made by the UAW could be made for several industries—especially if the automobile content requirements have the effect predicted by most analysts. If Congressmen continue to lend credence to these arguments, the end result could be a substantial reduction in world trade.

THE JOBS QUESTION

A number of predictions have been made about the impact of a domestic content requirement on jobs in the economy. By far, the most optimistic is that of the UAW. Fraser told Congressmen that a local content law would create 868,000 auto and auto parts supplier jobs in the U.S. by 1985.[71]

In arriving at this prediction, a UAW study assumes that in the absence of content requirements the market share of imports will increase to 35 percent by 1985 and the foreign content of American automobiles will rise from 3 percent in 1981 to

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[65] See, for example, Heeter, op. cit., p. 12; "Domestic Content for Autos?" World Trade Outlook, Vol. 4, No. 3, 1982, p. 8; or MacDonald testimony p. 9.

[66] Fraser, op. cit., p. 11.

[67] Ibid., p. 8.

[68] Nanto, CRS Issue Bulletin, p. 7.

[69] U.S. Trade Representative letter.

[70] Nanto, CRS Report, p. 14.

[71] Fraser, op. cit., p. 7.

10 percent in 1985. The proposed domestic content law, the UAW argues, would keep imports at 25 percent of the U.S. market, and those imports are expected to contain 59 percent U.S. content.[72] Based on these assumptions, the UAW estimates that the four U.S. automobile producers would employ 117,000 more workers by 1985 than they would in the absence of content requirements. Investment in the U.S. would lead foreign manufacturers to imploy 146,000 more workers according to the UAW model. Using Bureau of Labor Statistics data which indicate there are 2.3 supplier jobs supported by every one job in automobile manufacturing, the UAW estimates 605,000 jobs would be generated in the supplier industries. Thus the assertion that 868,000 jobs would be created.[73]

The UAW estimates have been widely criticized. A newsletter published by the American International Automobile Dealers Association (AIADA) notes that the UAW's claim is dependent on the assumption that foreign manufacturers will make the investments necessary to produce domestically the same number and model mix of cars they now import. The UAW apparently considers neither that foreign built plants might be more automated than U.S. plants nor that Japanese producers might decide to reduce imports. Either of these situations could significantly reduce the number of jobs created. Furthermore, the AIADA newsletter notes that UAW estimates for gains in U.S. employment among American producers represent the number of jobs that would be saved by preventing domestic firms from obtaining more components abroad. To claim these jobs would be "created" is, AIADA argues, misleading.[74]

A Congressional Research Service Issue Bulletin also questions the UAW estimates. First, Dick Nanto, author of the Issue Bulletin, examines the conclusion that 117,000 jobs will be generated among U.S. firms by holding their foreign content at 6 percent rather than 10 percent. Using a "normal" employment figure of 700,000 workers,[75] Nanto estimates that this 4 percent content saving would result in 28,000 jobs among the domestic producers. Using an estimate of 2.2 jobs in supplier industries for every auto worker's job, Nanto predicts 61,600 jobs would be created among suppliers. Nanto suggest the discrepancy between his numbers and those of the UAW is a result of the union's supposition that the market share of imports will rise to 35 percent without a content requirement. Many forecasts predict, however, that the import share will fall, not rise, in the future.[76]

Secondly, Nanto produces a lower estimate for the number of jobs that would be generated by substituting U.S. produced vehicles for imports. Under Nanto's assumptions, imports would be reduced by 1.58 million units. Supposing the demand for domestically produced vehicles increased on a one-for-one basis, there would be 1.58 million more cars produced domestically. On average output of 15 automobiles generates one job, so that employment would increase as a result of the import restrictions by about 105,000 jobs. Using the assumption that 2.2 jobs are supported in the supplier industries by each job in the automobile plants would lead to an estimate of 231,800 indirect jobs being generated.[77]

Thus, Nanto's estimates lead him to conclude that a maximum of 133,000 jobs would be created or saved in the auto industry and 293,400 jobs in the supplier industries. Total employment gains would, then, be at most around 426,000.[78]

Nanto's numbers are corroborated by an examination of recent experience in the industry. Since 1978, domestic automaker output has fallen by about 3 million units—resulting in the indefinite layoff of approximately 250,000 workers. (The number of imports has remained fairly constant.) Shifting the production of 1.58 million vehicles to domestic producers should, then, lead to the rehiring of slightly more than half of those laid off—133,000 by Nanto's estimates.[79]

These predictions are, however, optimistic. They assume a one-for-one transfer from imports to domestically produced automobilies—something unlikely to happen if prices rise substantially or consumers receive a negative message about American automobile quality from the proposed law. Furthermore, these estimates take no account of foreign investment in the U.S. in the absence of a domestic content law. Volkswagen is increasing its production capacity in its U.S. facilities. Honda plans to begin production soon in Ohio, and Nissan (Datsun) is building a plant in Tennessee that will produce 156,000 light trucks beginning in late 1983. Other investments are currently in the planning stages.[80]

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[72] Nanto, CRS Issue Brief, p. 2.

[73] Fraser, op. cit., p. 7.

[74] American International Automobile Dealers Association Newsletter, Vol. XII, No. 6, June 30, 1982, p. 2.

[75] In 1978, considered the last "normal year," American automobile producers employed 760,000 workers.

[76] Nanto, CRS Issue Brief, p. 3.

[77] Ibid.

[78] Ibid.

[79] Ibid.

These and similar considerations have led the Department of Commerce to estimate that possible job gains in the automotive and supplier industries would be no more than 110,000 to 200,000. In a letter to Representative Dingell, Secretary of Commerce Malcolm Baldrige notes that the Council of Economic Advisors estimates that a doubling of U.S. auto sales by 1985 would result in no more than 200,000 jobs in the auto sector.[81]

An even more important criticism is that the UAW figures fail to consider the jobs that will be lost as a result of domestic content requirements. Robert McElwaine, President of AIADA, predicts that the domestic content bill would close a minimum of 2,000 import dealerships, resulting in unemployment for 80,000 workers.[82] Furthermore, reducing imports jeopardizes jobs at the nation's ports. Darrell Trent, acting Secretary of Transportation, estimates that up to 11,600 direct jobs and 81,200 indirect jobs would be endangered in fourteen East, West, and Gulf ports.[83]

Jobs in other sectors may also be jeopardized. Baldrige notes that one out of seven U.S. jobs and one of three farmland acres are dependent on exports.[84] In fact, the jobs of some of the 200,000 UAW members employed in the agriculture equipment industry could be in danger.[85] In sum, if the content bills were to result in retaliation, the economy as a whole could easily lose more jobs than would be gained.

CONCLUSION

Domestic content bills for the automobile industry—H.R. 5133 and S. 2300—have been introduced in Congress in response to the success that Japanese auto manufacturers have experienced in the U.S. and the growing tendency of American firms to establish worldwide production. They are designed to protect the jobs of a particular group within the country—the workers in the auto and auto supply industries.

The UAW makes many claims in support of local content. Few other analysts make the same predictions. Most of the differences in opinion hinge on assumptions about the Japanese reaction—will they make the substantial investments anticipated by the act or will they reduce sales in this country and pursue compensation under GATT?

If Japanese firms do substantially reduce sales in this country rather than produce here, the American automobile market will become effectively closed. Prices will rise. Costs for American producers will climb as they are forced to relocate in the U.S. and as the autoworkers push for more wage concessions from their monopoly position. No longer will there be downward pressure on prices from abroad—or any effective incentive for U.S. manufacturers to pursue further gains in efficiency. Consumers will suffer not only from considerably higher prices, but also from a much narrower range of selection when choosing a new car.

For all of this, American automobile manufacturers will not necessarily be placed in a better position. Forced relocation and expected retaliation may make it difficult for U.S. firms to continue expanding in overseas markets. Perhaps the most significant statement about this bill is that the U.S. producers have *no* official opinion on it. They do not oppose it, but neither do they support the proposed law. Surely if auto manufacturers expected domestic content to be the panacea promised by the UAW, they would be out in full support of the legislation.

The employees of automobile import dealerships stand to lose, as will those companies handling their advertising and servicing. Individuals involved with the shipping of these imported vehicles around the country also will lose—those working at the ports as well as truckers. Beyond those workers directly involved with selling foreign automobiles in this country, employees of other industries may be hurt. If Japan decides to take action—either formally or informally—against U.S. exports, other industries will suffer. Even without retaliation, employees of other export related industries stand to lose. Artificially reducing Japanese automobile imports means that the dollar will appreciate overseas—making U.S. goods relatively more expensive on the world markets.

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[80] Ibid., pp. 3–4.

[81] Letter from the Secretary of Commerce Malcolm Baldrige to Representative John Dingell.

[82] McElwaine statement, p. 2.

[83] Secretary of Transportation letter.

[84] Remarks by Secretary of Commerce Malcolm Baldrige before the Chamber of Commerce Session on Local Content Bills, June 29, 1982, p. 3.

[85] Heeter, op. cit., p. 12.

In fact, the only clear winners under this proposal would be the autoworkers. With a strong domestic content law, autoworkers would have more power in negotiations with manufactureres and fewer worries about losing their jobs to outside competitors.

Even if some of the specific problems with the bill are resolved—exactly how domestic content will be defined, for example, or the effective "punishment" of firms already investing in the U.S.—problems remain with the very existence of this sort of market barrier. There is always a hefty price to pay when government erects obstacles in the marketplace. A domestic content law would be an enormous obstacle whose net effects for the economy almost certainly would be higher prices, perhaps reduced employment opportunities, and less choice for consumers.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman. I also want to compliment you and in particular the Heritage Foundation for the fantastic job that you do. I wish that we had a Heritage Foundation in every country.

Ms. ENGLAND. So do we.

Mr. BAILEY. And I wish that would be reflective of the kinds of value systems in those countries, and that politically you would have enough force to see that clauses in accordance with those things were written and you would not be here today testifying on domestic content, would you?

Ms. ENGLAND. No.

Mr. BAILEY. I have been a follower of the organization. I would like to sometime work with you. I think some of the work you have done particularly on human rights issues, et cetera, have stood for very basic American values that ought to be taught all across this country. I thank you very much.

Ms. ENGLAND. Thank you.

Mr. FRENZEL. I want to thank you for your testimony as well. I think it is a splendid presentation, and I think it corroborates and recapitulates most of the testimony that we have had before the committee. I appreciate your time, and assure you that the testimony will be of great benefit to us.

Mr. Chairman, I think we have completed the list of witnesses.

Mr. BAILEY. Thank you very much, Mr. Frenzel. I do not know what the chairman wants to do. Maybe we should hold until he gets back. Do you want to adjourn until a date certain or a time certain for hearings?

[Pause in proceedings.]

Chairman GIBBONS. This concludes the hearing today, and any future hearings will be at the call of the Chair.

Mr. BAILEY. I was tempted to say that, Mr. Chairman, but I was afraid that the record might show that the call of the Chair was coming from the wrong direction here.

Chairman GIBBONS. Thank you.

[Whereupon, at 1:10 p.m., the hearing was adjourned.]

[The following was submitted for the record:]

STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM THE STATE OF MICHIGAN

Mr. Chairman and Members of the Committee, thank you for giving me this opportunity to comment on The Fair Practices in Automotive Products Act (H.R. 5133), the local content bill that is now before your Subcommittee.

I am a strong supporter of this bill and am an original co-sponsor of the Senate version of the bill. I believe that this bill is good for the American economy and good for the American consumers who now are carrying a heavier and heavier tax burden to support the growing numbers of unemployed workers and people on welfare.

This bill gets at the fundamental question of fairness in international trade. That question is whether or not America—despite our historic economic strength—can allow another trading ally to ruthlessly exploit a short term situation in the world economy and threaten to destroy the heart of our national economy. If this ruthless trade invasion by the Japanese is allowed to continue, then we will witness the destruction of a major part of our economy, and a permanent lowering of the U.S. standard of living.

We cannot allow our American market to continue to be exploited in this manner. We are in a deep recession and our basic industries are extremely vulnerable to attack by countries such as Japan who were well situated to take advantage of the rapid and unprecedented shift that occurred in energy costs during the 1970s. Billions of dollars of scarce American capital have been taken out of this country by the OPEC countries and by the massive Japanese trade invasion. We cannot let this situation go on. It has happened too suddenly and at too great a degree for our basic industries to have any breathing room to adapt.

We have to face the fact that the principle of fair trade has been thrown out the window and replaced by a double standard in world trade practices where nations flood our markets with their products—while often closing their internal markets to U.S. built products. These international trade practices must stop now. This bill will bring a basic level of fairness to our trade laws and relations with other nations. And frankly, it is astounding to me that our government has taken so long to deal with this unfair situation that threatens our entire industrial base.

America's industrial base has been eroding dangerously in recent years. This crisis deeply worries a growing number of us here in Congress. As Senator from Michigan, the crisis has dominated work. Virtually every day, I have to deal with new consequences of that crisis—more lost jobs, more weakened companies, additional examples of unfair foreign competition and more fiscal disaster in state and local governments, as well as our federal government.

Based on that work, I have become convinced that this local content legislation would do much to help rebuild the U.S. industrial base. I believe that failure to enact this bill would hurt America's long-term position in world competition. For decades, American workers, businesses and taxpayers would pay dearly for that failure.

This legislation clearly establishes the principal that companies who sell a large number of cards to America should also help create jobs for Americans. It would give Japanese auto companies a strong incentive to introduce their manufacturing technology here, provide badly needed manufacturing jobs in the U.S., purchase parts and materials in the U.S., and invest in U.S. plants.

A broad segment of U.S. industry would benefit from this legislation. This is by no means a one industy bill. Auto manufacturing creates final demand for such key industries as glass, rubber, steel, plastics, aluminum, chemicals and electronics. In addition, this legislation would show that the United States is finally determined to do what is necessary to keep its basic industry strong, and many industries would benefit from that determination.

The U.S. Auto industry has been severely weakened during the last three years by a combination of high interest rates, lingering recession and rising Japanese imports. Auto layoffs are far above the officially reported level of 200,000 because thousands of unemployed auto workers are simply no longer counted. Auto manufacturers and suppliers have had to cut hundreds of millions of dollars from plans to improve their future products and manufacturing processes. Moreover, there is a growing fear that U.S. auto-related industries may not participate fully in any rebound in auto demand.

By contrast, Japanese auto firms have expanded their share of the U.S. market from 12 percent in 1979 to a record 27 percent in August 1982. Total imports captured a record 32.8 percent in August—the highest percentage ever. Less well known is that Japanese auto companies have been shipping more luxury cars here so that their U.S. profits have increased at an even higher rate than their unit sales. The Japanese are targeting precisely those U.S. consumers who will lead any recovery of auto demand over the next year or so.

As a result, the U.S. auto trade deficit with Japan rose to an annual rate of $13 billion in the first two quarters of 1982. Those financial flows provide Japanese companies with a hugh industrial war chest with which to challenge U.S. competitiveness in years to come.

Mr. Chairman, the U.S.—alone among all auto producing countries—has had no effective response to the Japanese strategy to expand auto exports. Other governments have acted to protect their nations's economic interests against foreign import expansion. Many American officials oppose similar actions for the U.S.—they warn that the U.S. would suffer dire consequences of retaliation and they suggest ineffective alternatives. This committee, I am told, heard such warnings and advice from Administration witnesses yesterday. Those arguments are not convincing, and only reflect the Administration's ideological bias against any public policy that would help a specific industry.

First, the Congress need not be paralyzed by threats of trade retaliation.

Over thirty countries now have auto content rules—many of them are far more stringent than those provided in this legislation. No country has had its local content rules challenged under GATT procedures.

Only Japanese and U.S. companies would be affected by enactment of this legislation. Other countries would have no reason to retaliate. Japan has very limited ability to retaliate against the U.S. because it tends to buy from us only what it needs. If Japan were to file a complaint, the U.S. could file counter charges against Japanese complicity in the auto trade restraint policies of Europe, Australia, Indonesia and Latin America. Such countercharges were effectively used in 1971 when several European countries objected to U.S. Domestic International Sales Corporation (DISC) legislation.

Second, Congress must insist on action that is effective, and this legislation will be effective.

The Japanese have shown themselves to be very shrewd in international trade matters. Time and again, just when Japanese penetration of the U.S. markets was about to bring an effective American response, the Japanese have made some minor concession or promise to deflate Congressional resolve.

In 1981, for example, the Japanese voluntary agreement to limit auto exports, halted efforts in Congress that would have prevented the Japanese share of U.S. auto sales from endangering the domestic industry. That agreement was supposed to hold the Japanese market share to 16.8 percent. Instead, the Japanese share has continued to soar.

Some opponents suggest that, instead of enacting this local content legislation, the U.S. should ask the Japanese to raise the value of the yen against the dollar. That would only waste valuable time. The Japanese will do nothing to relieve the pressure on our economy so long as they are assured that the U.S. government will make no effective response.

The Reciprocity Bill (S. 2094), of which I am an original cosponsor, also is no substitute for the legislation that you are now considering. As reported in the Senate, the Reciprocity Bill essentially extends existing Trade Act protections to service industries. It does not deal with problems in manufacturing industries.

I am sure you will hear testimony here in this committee about how wrong it is for America to turn its back on total open "free trade." You will also hear testimony to the fact that if only the Japanese would revalue the yen upward, the price differential on their products would disappear. These philosophical arguments simply do not take into account the practical realities of international trade, or the hard truth that the Japanese and others will continue to act entirely in their own self interest. It is time to protect American self interest—and save the industrial strength we need to defend ourselves and the free world.

Only when this Congress passes domestic content legislation, reciprocity legislation and temporary quota legislation—all of which I strongly support, will we begin to see some basic measure of fairness and equity returned to international trade practices.

The Fair Practices in Automotive Products Act is the only legislation now moving in Congress that provides relief to America's workers. I believe that the legislation now before this Committee will be an effective U.S. response to the worsening auto trade crisis. With time fast running out on this Congress, I strongly urge you to act favorably on this bill.

STATEMENT OF AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

As the national trade association representing the major domestic manufacturers of commercial and business aircraft, jet engines, helicopters and related components and equipment, the Aerospace Industries Association of America, Inc. (AIA) appreciates this opportunity to express our deep concern with H.R. 5133, the domestic content legislation recently considered by this Subcommittee. We commend the Subcommittee, and particularly the Chairman, for their efforts to ensure that this legislative proposal receive careful and in-depth examination by the Congress in view of what we perceive to be its far-reaching and adverse consequences.

H.R. 5133, which would require automobile manufacturers with substantial sales in the U.S. market to use high levels of "North American content" (i.e., U.S. labor and U.S. or Canadian parts), poses a number of serious problems. The local content requirements would, in effect, operate like quotas. Such restrictions would not quarantee that U.S.-produced automobiles would become price-competitive with Japanese automobiles: if anything, the imposition of domestic content requirements would eliminate a principal cost-cutting devise—the use of foreign-supplied parts. Additionally, the restrictions detailed in H.R. 5133 would isolate the U.S. market from international competition, thus removing certain restraints on pricing and wage levels.

The job-creating potential of this legislation is also questionable. A 1981 study of H.R. 5133 by the Congressional Research Service predicted that higher automobile prices resulting from enforcement of domestic content requirements will further dampen demand, and hence, suppress new job creation. At best, the Council of Economic Advisers estimates that net job gain—exluding potential retaliatory effects on our exports—would be under 50,000 jobs at a cost to the economy of up to $100,000 per job. Furthermore, the proposed legislation could have a devastating impact on the approximately 165,000 American jobs upon auto imports.

AIA is opposed to measures which direct the procurement of goods and services to protect domestic industries. AIA member companies have had long-term, relevant experience with government-directed procurement both as a competitor of foreign companies who are wholly or partially owned by their respective governments, and also with many international customers who are government-owned or managed. We firmly believe that our products are competitive anywhere in the world, although trade distorting practices—such as government-directed procurement—pose serious problems for our privately held aerospace companies. AIA therefore opposes efforts within the Congress to protect specific domestic industries and feels that proposals such as H.R. 5133 will have serious negative economic and trade consequences for a broad spectrum of U.S. companies who are engaged in international trade.

As written, H.R. 5133 would place the United States in violation of several provisions of the General Agreement on Tariffs and Trade, and consequently, would enable other signatory countries to bring formal complaints under Article XXIII. United States Trade Representative William Brock has noted that such complaints are more than likely to be unheld, with the probability that the United States will be required to abolish its local content restrictions. Failure to so comply could result in retaliation by other GATT countries against a wide range of American exports.

AIA's member companies are particularly concerned with the potential for such a confrontation. Aerospace exports totaled over $17 billion in 1981, and the aerospace industry chalked up the best trade balance among U.S. manufacturing industries. Due to the nature of government influence in our international competitions and the high cost and visibility of our products, we feel that the aerospace industry would be particularly susceptible to retaliatory actions should the U.S. impose domestic content requirements as set out in H.R. 5133. Other successful U.S. exporters would also be likely targets for reciprocal protectionist actions if this legislation is approved, entailing subsequent losses in employment and tax revenues.

If enacted, H.R. 5133 would make the United States the first major auto producing nation to adopt domestic content requirements—a situation inconsistent with out international obligations, and irreparably damaging to the Administration's current efforts to open foreign markets more fully. Rejecting the free trade policy that has enjoyed bi-partisan support will ultimately cost the United States jobs, sales, markets and economic growth—in all industrial sectors.

In light of the negative consequences that can be expected to flow from this legislation, we urge you to oppose these and similar protectionist proposals now pending before the Congress.

American Isuzu Motors, Inc.

Hon. Sam M. Gibbons,
Chairman, Subcommittee On Trade,
Washington, D.C.

Dear Congressman Gibbons: I have been asked to appear before your Subcommittee on Trade which is scheduled to meet on Wednesday, September 29, 1982. I appreciate the opportunity but, due to the recent scheduled changes for that testimony, I now find that I have a conflict with my travel plans which will not permit me to appear.

Because I feel so strongly about the matter of international trade, I am attaching a transcript of the testimony which I was prepared to submit.

I do want to let you know Congressman, that, all of us involved with international trade, appreciate your interest in the matter. Bills such as H.R. 5133, while perhaps giving temporary relief, will in the long run, undoubtedly damage American industry in every sector.

Thank you for your interest and perhaps we will have the opportunity to meet personally sometime in the future.

Sincerely,

J. E. REILLY,
Senior Vice President,
General Manager.

Attachment.

STATEMENT OF JOHN E. REILLY

My name is John E. Reilly and I am Senior Vice President and General Manager of American Isuzu Motors Inc., 2300 Pelissier Place, Whittier, California 90601.

In my 25 years in the automobile business I have been associated with, and held management positions with General Motors Corporation, Volkswagen of America, Inc., Toyota and now with Isuzu.

American Isuzu Motors Inc. was incorporated on June 11, 1980 which was prior to the voluntary restraint program implemented by the government of Japan.

Isuzu Motors Limited of Japan is Japan's oldest manufacturer of automobiles, having been formed in 1916. Over the years and up to the present, Isuzu's reputation world wide has largely been based on their diesel technology and on the manufacture and production of medium and heavy duty trucks and buses as well as passenger cars.

In 1970, General Motors purchased 34.2 percent of Isuzu Motors Ltd. (Japan) stock and began the importation of Chevrolet LUV trucks and Buick Opel automobiles. In the mid-1970's, General Motors began planning to produce similar vehicles in the U.S. and discontinued the importation of the Buick Opels and will probably discontinue the importation of Chevrolet LUV trucks in 1983. When this probability was enunciated, Isuzu decided to market their highly efficient diesel and gas vehicles in the U.S. This decision was made in the mid-1970's and as I have already indicated, we incorporated here in June of 1980.

The reputation of Isuzu is well known in the automotive community and even in 1980, when automobile and truck sales were declining sharply, there were over 3,000 applications from American businessmen who wished to invest in Isuzu franchises.

Since 1980 we have appointed some 300 dealers but have been unable to give all of them both cars and light duty trucks. As a matter of fact, once the voluntary restraint program was announced, Isuzu's passenger car quota was limited to only 16,800 units. Trucks, bearing a 25 percent "chicken war" tariff, are unrestricted. At that point in time nearly 200 dealers had already invested approximately 48 million dollars in facilities to house the Isuzu franchise. In addition to the real estate investment, these dealers have employed over 1,400 Americans to work in their dealerships. Our modest company had purchased a building in California for over 10 million dollars and has opened regional offices in both Atlanta, Georgia and Chicago, Illinois. Isuzu currently has over 200 Americans employed in the U.S.

All of this employment and all of this investment has taken place during a 2½ year span of time which has probably been the worst time frame for the automotive industry since World War II. The fact is however that American dollars have been invested, American people are employed and all of this is somewhat at risk due to the emotional attention being given to Bills such as H.R. 5133.

Our dealer organization will retail approximately 35,000 units this year and will not reach the 100,000 minimum level as specified in H.R. 5133 until 1985 or 1986 at the earliest. Perhaps we should just be quiet and not make waves because certainly, as a smaller manufacturer, we are in a rather insulated position for the time being. My concern however is for the severe effects that "protectionist bills" such as the one I have been referring to will have on the United States because of what undoubtedly will be the reaction of other countries around the world.

I certainly believe that all countries should have free trade policies and that the best product should be available for anyone in the world who wishes to buy it and that the prices should be as competitive as possible and not subject to artificial restraints or bureaucratic delays.

The perception which the average individual has of Japan is that it's unfair in its trading practices. Everyone presumes that the Japanese love to export freely but have built giant walls around Japan so that outsiders cannot do business within their country. This obviously is not true otherwise IBM could not be controlling 30 percent of the computer market in Japan. DuPont sales in Japan which last year exceeded 700 million dollars could not have occurred and could not have shown sales increases at the rate of 20 percent per year. The average return on investment for foreign companies doing business in Japan is 19.5 percent which certainly shows that people can do business with Japan and can be profitable. Budweiser has recently announced that they expect their Japanese importer to sell over one million cases of Budweiser this year. That's twice as much as last year even though Budweiser is priced substantially higher than the Japanese brews. Budweiser's done an excellent job in promoting their beer with a certain amount of snob appeal and the Japanese are buying it.

Other companies like Coca Cola, Nestle Instant Coffee, General Foods, Lipton Tea, Procter & Gamble, American Drug, Polaroid, Kodak, Dunlop have all succeeded in Japan and are doing extremely well.

As for protected industries yes, there are a couple such as the beef and leather industries which are protected not only because of economic reasons but because of reasons which have their foundation based on religious and political considerations. As a matter of fact, even if all restraints were removed on beef, the probability is that Australia would benefit almost exclusively from that action. In spite of the internal problems Japan has promised to, and has been eliminating, many tariff barriers which have been urged by the U.S.

Just a note on tariffs, its interesting to note that Japan has zero percent tariffs on automotive products while we have 2.9 percent duty on passenger cars and 25 percent duty on trucks. Yes there are internal automotive tariffs in Japan which are based on weight and horsepower but I submit that they do not seriously differ from the internal, state registration taxes here in the U.S. (our internal tariffs.)

Most of the studies that have been submitted to the Subcommittee have I believe, proven conclusively that restraints such as the current "voluntary" ones do not provide additional employment or increase American automotive sales. To the contrary, restraints which do not give the U.S. consumer a free opportunity to buy, could dangerously affect the investment of those American automobile dealers who have invested in import franchises. Quotas increase prices and when that has happened in the past the U.S. auto makers raised their prices to maintain the same price differential between the U.S. cars and the imports. Who gets hurt? The consumer.

The purpose of my testimony has not been to restate the facts and figures regarding employment or unemployment; not to show what may happen if the countries in the world are eventually forced to produce here if they want to do business here. My intention is not to reiterate that Bills like H.R. 5133 are probably a violation of the GATT Agreements. My intention is to show that a small company like Isuzu, in a depressed market can provide an opportunity for businessmen, can provide employment for thousands of Americans, and can provide a product which has some demand by the American consumer and a product which can be purchased at a reasonable price.

I firmly believe that American industry can produce quality goods at competitive prices for the world. It will take hard work on the part of labor and management and it can be done without starting an international trade war.

Thank you for your attention.

JOINT STATEMENT OF THE AMERICAN SOYBEAN ASSOCIATION, NATIONAL ASSOCIATION OF WHEAT GROWERS, NATIONAL CORN GROWERS ASSOCIATION, NATIONAL COUNCIL OF FARMER COOPERATIVES, NATIONAL FARMERS UNION, AND NATIONAL GRANGE

The above agricultural organizations oppose the proposed domestic content legislation, H.R. 5133 and S. 2300, and we urge you to vote against it. Agricultural exports from the United States exceed $42 billion per year with a favorable balance of trade of more than $25 billion per year. The imposition of protectionist legislation of this kind could seriously jeopardize that balance of trade if other countries were then to adopt retaliatory measures which would adversely impact on agricultural exports.

We share the frustration of other U.S. exporters, our fellow Americans, and our trading partners around the world over the growing trend toward protectionist actions which would disrupt world trade. But we believe that domestic content legislation is not the proper approach in dealing with those problems. Indeed, we believe that such legislation would be counterproductive and potentially damaging to long-term prospects for expanded world trade.

THE BUSINESS ROUNDTABLE,
Washington, D.C., September 24, 1982.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR MR. ROSTENKOWSKI: Currently Congress is considering H.R. 5133, the "Fair Practices in Automobile Products Act." I am writing to present the strong opposition of the Business Roundtable to the bill.

If enacted, H.R. 5133 would impose stiff domestic content requirements on both foreign and domestic automobile manufacturers that sell more than 100,000 vehicles in the United States each year.

We recognize the objective of this legislation is to create jobs. However, we believe the legislation, if enacted would have the opposite effect on U.S. employment. If the United States imposes local content requirements on automobiles sold here, we risk the threat of retaliation against U.S. exports in foreign markets. Retaliation could harm those industries where the United States enjoys a competitive advantage and thus have a negative impact on employment.

Enactment of local content legislation could jeopardize the United States' efforts to persuade other countries to open their markets more fully to U.S. trade and investment. The United States has launched a number of bilateral and multilateral initiatives aimed at opening and improving the international trading system to the mutual benefit of all nations. These initiatives could well be frustrated by adverse international reaction to enactment of a local content law.

U.S. endorsement of such protective trade policies deal a severe blow to the international trading system. We have traditionally been a leader in calling for a reduction in trade barriers. We cannot expect other nations to heed that call if we begin to erect barriers ourselves. As the world's greatest trading nation, the United States clearly has the most to lose from increased protectionism.

Congress had rarely, in modern times, legislated specific trade protection for industrial sectors. To do so now would undermine the integrity of U.S. law enacted to address unfair trade competition, such as Section 201 and 301 of the Trade Act of 1974. It would be self-defeating for the Congress to undermine the statutes it enacted to deflect political pressures for trade protection. The passage of local content requirements would invite such pressures.

The U.S. must sustain its commitment to breaking down trade barriers. Congress has given us some tools to work with. Others, like the Reciprocal Trade and Investment Act of 1982 are being considered. The Business Roundtable supports its enactment.

With these tools, the United States should be aggressive in maintaining the position of its companies in the international marketplace. But we must draw a line between aggressive assertion of our interests, and support for protectionist measures that will do more harm than good, in the long run.

Protectionism is a poor substitute for bilateral discussion and trade negotiations within a multilateral framework. The United States should continue its efforts to dismantle trade barriers rather than to erect barriers of its own. Only the maintenance of an open international trading environment will serve the long-term interests of U.S. manufacturers and producers and, in turn, provide secure employment.

Again, the Business Roundtable urges defeat of H.R. 5133.

I appreciate the opportunity to present the Business Roundtable's views.

Sincerely,

LEE L. MORGAN,
Chairman,
Task Force on International Trade and Investment.

STATEMENT BY MICHAEL S. DUKAKIS, DEMOCRATIC NOMINEE FOR GOVERNOR OF MASSACHUSETTS

As the Democratic nominee for Governor of Massachusetts, I respectfully urge your Subcomittee, and the full Committee on Ways and Means, to report favorably on H.R. 5133, known as the Domestic Content Bill, or the Fair Practices in Automotive Products Act.

Passage of this legislation is crucial to the economic health of Massachusetts in general, and of the South Middlesex area in particular, where 3,400 men and women will be laid off as of October 1 at the General Motors assembly plant in Farmingham. In a state where well over 200,000 are already unemployed, the loss of 3,400 jobs is simply unacceptable. The General Motors plant currently generates an estimated $105 million in annual economic activity in the South Middlesex area, and a layoff of long duration would be devastating.

Moreover, as one who has served as Governor of a major industrial state, I believe that a national economic recovery of strength and durability is impossible without a revitalized domestic automobile industry. The 868,000 jobs which would be retained or recaptured if Content Bill were implemented would be matched or exceeded by a ripple effect reaching out to virtually every sector of our economy.

I have a lifelong commitment to the ideal of free trade among nations, and do not come easily to the support of measures which contradict that spirit. The Content Bill, in my judgment, does not.

Free trade works when it is a two-way street, and the automotive trade, at least with Japan, has been anything but that. The Content Bill is not designed to shut out foreign cars—on the contrary, its supporters note that two major European manufacturers, Volkswagen and Renault, are well on the way to compliance already, through investments they have made in American facilities. This legislation is designed to give the domestic automobile industry a much-needed opportunity to adjust to changing market preferences that have coincided with a strong, one-way thrust into the domestic market by Japanese manufacturers.

Last year, General Motors invested $100 million in retooling its Framingham plant for the efficient production of new model lines. Whether that investment is used for years to come, or is allowed to go to waste as our domestic automobile industry continues to decline, will have a profound impact on the future of my state. I join the United Auto Workers, and the Massachusetts Congressional delegation in urging passage of one Federal law that could make a difference.

JACKSONVILLE MARITIME ASSOCIATION, INC.,
Jacksonville, Fla., September 30, 1982.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for the chance to comment on the amended HR5133, Fair Practices in Automotive Products Act.

The imposition of quotas on import auto products may well bring retaliatory action by the countries involved. Considering that the U.S. enjoys an export market to Japan of over 10 billion dollars, this is a substantial amount of jobs, taxes, etc. to put in jeopardy. It would also seem to refute the U.S. philosophy of open trade (capitalism) vs government-controlled economies of socialism and communism.

We would, however like to point out that even if there are no retaliatory quotas set by Japan, the consequences of HR5133 would have a tremendously adverse economic impact on the State of Florida.

In Jacksonville, Florida, we receive over 500,000 import car units annually. The two largest importers are Datsun and Toyota, who would be hardest hit by this bill. Car imports in Jacksonville account for an average of 350 vessels annually. Tugboats, pilotage, dockage fees, longshoring, agency work, U.S. Customs, brokers, (how much revenue to U.S. Customs will be lost by HR5133?) processors, trucking companies and many more people are dependent on this business. Revenue benefit to North Florida is estimated to be in the hundreds of million dollars by the local Port Authority.

As an example tugs, pilotage, and berthing alone will average more than $7,000 per ship. The auto processors have more than 1,500 employees installing radios, air conditioners, truck bodies, vinyl tops, striping, bumper guards, special lights, toppers etc. All these products are of American manufacture and amount to more than $18 million dollars a year.

In addition to this the Japanese use dollars from auto sales to purchase substantial amounts of Florida citrus (see attachment). It is reported that Japan is Florida's largest citrus customer, and the volume amounts to 75,000 tons annually.

If quotas are put on Datsun and Toyota, the West Coast U.S. area could absorb all the units they would be allowed to bring in. As a result, it is anticipated that both Datsun and Toyota would discharge autos only on the West Coast thus saving the transportation costs of 8 days ship running time and Panama Canal tolls. If any citrus is loaded from the West Coast it would undoubtedly be California produce.

All of this is likely to happen if HR5133, passes and there is no retaliation from the Japanese. If retaliatory quotas or embargoes are introduced by the Japanese, the problem will be greatly magnified.

Whether or not this bill will help the U.A.W. is uncertain. The potential damage and unemployment in Jacksonville is certain. Speaking for all of the port interests in Jacksonville, both management and labor, we are opposed to this bill.

Sincerely,

VERNON MCDANIEL, Jr.,
Executive Director.

Attachments.

A UNIQUE TWO-WAY TRADE CONCEPT IS WORKING

In cooperation with Toyota, the Great American Lines Company (G.A.L.) of the United States designed the Sunbelt Dixie, a cargo vessel built expressly for the transportation of Toyota vehicles to the U.S. and the shipping of citrus exports from the U.S. to Japan on the return trip. Its unique configuration includes refrigerated compartments for citrus cargo.

The ship has a carrying capacity of 3,300 Corona class vehicles and refrigerated compartments that can hold the equivalent of 280,000 cartons of grapefruit.

The vehicle transportation charges for using the Sunbelt Dixie are paid by Toyota Motor Sales Co., Ltd., in U.S. dollars directly to G.A.L.

Toyota management felt that utilizing the return trip to export U.S. products to Japan represented a concept that would help encourage two-way trade between the two nations.

MASSACHUSETTS INSTITUTE OF TECHNOLOGY,
DEPARTMENT OF ECONOMICS,
Cambridge, Mass., August 31, 1982.

Hon. SAM M. GIBBONS,
Chairman, Committee on Ways and Means,
U.S. House of Representatives, Washington, D.C.

DEAR CHAIRMAN GIBBONS: Because my schedule will not permit me to testify in person on the domestic contents bill, H.R. 5133, and because my researches show that the American standard of real wages and real per capita income is more likely to be hurt by import protection than helped, I enclose for use of your committee my article "To Protect Manufacturing?".

This article was prepared at the request of West German economists but its findings apply also to the United States.

Sincerely yours,

PAUL A. SAMUELSON,
Institute Professor.

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To Protect Manufacturing?

by

*Paul A. Samuelson**,

Cambridge, Mass.

The third quarter of the Twentieth Century was a golden age of economic progress. It surpassed any reasoned expectations. And we are not likely to see its equivalent soon again.

International trade contributed mightily to the postwar miracle, something that could not be taken for granted in 1945. The depression decade of the 1930s saw the breakdown of the gold standard; it involved competitive tariffs, quotas, and selective exchange controls designed to protect overvalued currencies and domestic employment. The Bretton Woods system was set up in 1944 out of the fear that, after war's end, there would be a continuation by other means of the interferences with free trade and the international division of labor that had become customary during the 1930s.

When we congratulate ourselves on getting rid of the Bretton Woods fixities of parities, it is only fair to remember that the quantum of international trade surpassed the miracle rates of domestic growth in the sensational 1950s and 1960s; and it was under the Bretton Woods regime that this salutary development took place. Japan, the Common Market countries, and all those regions that have increased their share of world GNP at the expense of North America the leader, should keep the flowers growing on the grave of the Bretton Woods system, in grateful remembrance of its transitional role in rectifying the initial peacetime undervaluation of the American dollar. It was not a good thing for the world that the United States enjoyed in 1945 almost half of real world GNP. And it is not a bad thing for the United States that our share has been reduced to about one-quarter of world GNP: our people have grown in average per capita affluence while Sweden, West Germany, and Switzerland have gained somewhat on us; under healthy world development the U.S. share of the world total will continue to drop, even though our 6 percent of world population continues to be at the top of the scale in *per capita real GNP (correctly* calculated à la Professors Kravis, Summers, Heston, and their Pennsylvania colleagues).

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* Paul A. Samuelson is professor of economics, Massachusetts Institute of Technology.

Free Trade at Bay

My concern is with the future. Comparative advantage is not static. Economic law suggests to me that much of manufacturing industry will try to leave Western Europe and North America under free trade. This is not a new thing. It is not a peculiar consequence of the presentday regime with its reliance on floating exchange rates. But it is an intensification of older trends that will certainly put a strain on the ideology of free trade.The political pressures for protectionism, I suspect, are about to intensify.

The purpose of economic theory is to alert us to the direction of change, to a reasoned evaluation based on evidence of the probabilities and improbabilities. Along with this positivistic service, economic theory also has the normative purpose of setting out the likely consequences of alternative policy programs. Until electorates and leaders learn what are the menues of choices, they cannot arrive at their optimal selection of acts.

The plain person, unburdened with knowledge of economics, is prone to fear that free trade will wipe out jobs and decimate real incomes. Some sophisticated economists, such as Nicholas Kaldor and other U.K. Labour Party analysts, agree with the notion that loss of manufacturing jobs by free trade will bring loss of national standard of living.

A diametrically opposite conclusion is presumed by the unthinking ideologue of free trade: to him, so to speak by very definition, what free trade brings is the optimum; on this view, a world without tariffs and artificial trade impediments, would have to bring to every region and every person an ever increasing real income. Although Kaldorian mercantilism might be empirically either wrong or right, the deductive syllogism that free trade maximizes each market participant's welfare is logically false. Even under the strict conditions most suitable for perfect competition particular market participants win and lose from ever-occurring shifts in supply and demand.

The correct *theoretical dogma* on free trade is this:

> Under conditions suitable for perfect competition, free trade is efficient in the sense of wiping out *global deadweight loss*. If you deviate from free trade, those who gain from so doing gain less than those who lose lose – in the sense that the losers could afford to bribe the winners to desist from protectionism.

It is naive to think that it is politically feasible (or even desirable) for protectionism in Western Europe and North America to be bought off by such developing industrial states as South Korea, Taiwan, Singapore, or Hong Kong. Aside from political unfeasibility, bribes from the less affluent to the more affluent are not ethically aesthetic.

The free trader, emancipated from false theoretical dogma, will rely rather on an empirical long-run presumption:

> Eschewing trade impediments with their concomitant deadweight losses is likely to bring benefit to a *random* person or regime, in the *long* run, *averaging* out the happenstance of particular gains and losses resulting from supply-and-demand shifts in tastes and technologies. ("What you lose on the swings, you gain on the round-abouts...")

Concretely, as applied to Europeans and Americans apprehensive about their losing comparative advantage in manufacturing, the free trader argues:

> It is not clear that the already industrialized societies lose more than they gain from the development in the new industrial regions of comparative advantage in manufacturing. Cheaper imports have contributed much to the real living standards of the affluent nations. What Nagoya gains is not necessarily what Detroit, Turin, and Düsseldorf lose. What South Korea gains, may be part of what North America and Western Europe stand to gain.
>
> Moreover, suppose it should turn out to be the case that supply-and-demand shifts are tending to hurt the richer nations. Not all hurts can be usefully assuaged by protectionism. Often quota and tariff interferences will add some self-inflicted wounds and leave you twice badly off, at the same time that some deadweight loss is being borne by the developing nation.

How Can Imports Hurt Us?

Noneconomists naively assume a fixed number of jobs. If Japan gets some good jobs that Germans used to have, that is supposed to be a clear cut loss to the German nation.

Economists know better. We know that good German jobs in the textile industries are often lost when better German jobs in the chemistry and machinery industries raise general wage rates above what can keep the German textile industries alive in the face of Taiwanese competition. Japan, having won much of New England's share of the world textile market, in turn loses textile jobs to Korea when Japanese textiles can't hold their workers against the pull of better paying Japanese industries.

Suppose that the Gang of Four – South Korea, Taiwan, Singapore, and Hong Kong – improve their technology dramatically. How does that affect U.S. and German workers and capitalists if we continue with the same slowly improving technology?

I must distinguish[1] whether the Asian improvement came

1. in goods they traditionally export to the West,
2. in goods that have such heavy transport costs that they don't enter into trade on the export or import side,

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[1] See DORNBUSCH, FISCHER, and SAMUELSON [1977] for a convenient model to analyze these problems.

3. in goods that can't in any case be produced in the face of Western competition,
4. in goods that we used to export to them but which now they can export competitively to us or at least produce for domestic consumption,
5. in some combination of the above four catagories.

Case 1. The first of these categories is the one dogmatic free traders concentrate on. It is an unmixed blessing to the West to get our imports cheaper. Our terms of trade improve. Our *real* wage rates rise. Our consumers' surplus from international trade rises. Job opportunity rises even in our non-tradeable-goods industries and in the industries where our exports are unchallengable. The resulting increase in our general wage rates, the free trader will admit, does drive out of existence some borderline industries previously just hanging on to their markets in the face of actual and potential Asian competition. But, the free trader can correctly point out, these industries lose workers because workers are bid away by now more-productive job opportunity.

Abroad, one can't be sure. Probably real wage rates rise there as a result of their technological advances. Certainly that must follow if their new supplies are not so flooding world markets as to turn their terms of trade against themselves by so much as to make their technical improvements be immiserating changes.

Case 2. Europeans of goodwill can bless technical changes that make local Korean goods more available to previously poor Koreans. To the extent that this releases resources into Korean export industries and also enhances Koreans' demands for goods imported from the West, this case's technical change will improve the West's terms of trade, its real incomes, its consumers surplus from trade. Though Asians may lose consumers surplus, they probably are net benefitters from the technical change. (Only if demands for their exports are so inelastic as to make the induced deterioration of their terms of trade great enough to offset the boom of domestic productivity, would Asians be hurt in this second case.)

Case 3. I mention this case though it has no effects whatsover. A great change is unlikely to occur, or be recognized, in an industry that Asia can't afford. If now Asia still can't afford the industry, even if it comes closer to being able to do so, there will be no effect on anyone.

Case 4. Here the honest free trader must admit that the West could be hurt by better productivity abroad. The West loses consumers' surplus from trade as the West's terms of trade are hurt by undermining of her export-goods prices relative to her import-goods prices.

The extreme case, would be where South Korea came to have *exactly* Germany's *comparative* productivities, industry by industry. (Warning: even if *every* Korean industry came to have exactly one-half Germany's real productivity, when Korea's real wage rate were one-half Germany's all trade between the two countries would cease.) If Asian technical change occurs thus in all the goods Germany used to export, and all trade ceases, Germany has lost the consumer surplus formerly enjoyed from trade[2]. This is the germ of truth – one of the few germs of genuine truth – in the Marxian notion that the West might lose something if the East became exactly like the West.

Job opportunity in the West might temporarily suffer if money wages lagged in Asia behind the growth in productivity, creating an export surplus there and a trade deficit in the West. Floating exchange rates would take care of this: as the Western currencies depreciated relative to the Eastern, full employment equilibrium would be restored in both places; the final drop in Western *real* wage rates cannot be blamed on the mechanism of floating, since it is an unavoidable implication of Case 4's technical change.

Note this: Even when the West is hurt, there is nothing that can be done about this hurt in the case where the East comes to have the exact same comparative productivities industry by industry as the West. Even acting in concert, the West has no monopoly power to exploit vis-à-vis the East. Admittedly, in less extreme versions of Case 4, if concerted action by the West exploits some of its monopoly power that had previously been unexploited, some (or all) of the induced loss in Western welfare might be mitigated – a problem I return to later.

Before leaving positivistic analysis of how Western welfare is affected by Eastern inventions, I ought to deal with Club of Rome problems. Oil and other geologic deposits are limited. If a Korea joins the ranks of the affluent nations much as Japan had done before, Korea will have real bidding power for OPEC oil and limited food supplies. Western Europeans and North Americans will have lost a little of the privileged access to bidding for those scarce resources which their previous exclusive affluence had given them. Again, the Marxian suspicions of conflict of interest between the rich and less-rich regions is seen to have some basis in fact.

Protectionist resistance to manufacturing imports is not a weapon well gauged to counter the West's potential loss in welfare. The West's knife may cut against itself in scratching at its rival. Let us see why.

Monopoly Power to the Rescue?

I have no wish to rebut dogmatic protectionism by dogmatic libertarianism. A fairminded economist must admit that North America and Western Europe, if they could collude to act concertedly in their own self interest, may be big enough to possess some genuine degree of exploitable market power (monopoly power). It is not a theoretical impossibility that, in departing from free trade in a way that is optimal from their selfish viewpoint, they might force a loss on the newly industrializing regions that exceeds the global deadweight loss induced by newly contrived imperfection of competition.

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[2] If Asian technical change proceeds even farther, cheapening relative costs of the goods that have shifted over from being their imports to being their exports, such further changes are covered by my previous Case 2 and don't have to be analyzed here in Case 4.

Theoretical possibilities have to be judged in terms of practical possibilities and empirical quantitative importance. I know that a tight cartel of the affluent nations is unfeasible: I doubt that a loose confederation, in which the separate European and American countries simultaneously give in to their domestic union and business manufacturing interests, has much monopoly power to exploit.

What Is to Come?

Rational world economic development will probably call for the following end of century trends:

1. Manufacturing, particularly the simpler processes that all can imitate rather easily, will move toward the developing world.

2. North America and Europe will shift resources toward sophisticated technologies, service industries, and headquarter functions – in that way contributing both to their own self-interests and the interests of the less affluent.

3. The successful developing societies will gain on the leaders in real per capita incomes, just as the United States was gained on in the 1945–80 period.

Most of the newcomers' gains will come out of *their own enhanced productivities* and not out of the hides of the peoples less affluent than them or more affluent than them. However, to the degree that global geologic resources are unrenewable and limited, the new bids for such resources by Koreans and Japanese must contribute a little toward more unfavorable terms of trade facing Indians, Chinese, Eastern and Western Europeans, and Americans all over the New World.

4. Only after the LDC's that have not yet experienced a manufacturing take-off succeed in their hoped-for industrial revolutions and only after they have succeeded in controlling their explosive population growths; only then will the affluent nations stand to lose some of the historic consumer surplus that they have enjoyed from international trade – trade that historically involved imports of fiber, food, and ores produced in the tropics by low-wage populations. Hong Kong and Singapore, to say nothing of Taiwan and Korea, have up to this time harmed the West little by reducing their exports of staples. If that happy day comes when South-east Asia, Africa, and Latin America afford a comfortable middle class standard of living to their stabilized populations, we should be content to depend upon mechanized mines and farms for our needed raw materials, uncomplainingly paying the necessary costs for the goods we need.

5. With the demise of colonies, the evidence mounts that India is not poor because Sweden is rich or because Citibank is profit seeking. If all the globe

were as poor as India, the next few generations of Indians (and of Mainland Chinese too) would face less favorable rather than more favorable prospects. Such a conclusion runs squarely contrary to the run-of-the-mill Marxian ideology. Before 1917, when the quantitative importance of colonialism could only be guessed at and prior to availability of experience with actual real growth under Soviet and East European socialism, the evidence bearing upon the putative validity of the Marxian ideology was necessarily scanty. In the Age of Lenin and Castro, the reasoned odds narrow down.

Qualifications

Comparative advantages are to be reckoned in dynamic not static terms. Mexican manufactures not yet viable in 1981 will undoubtedly hold their own in 1991. If empirical evidence and cogent logic supported Kaldor's contention that U. K. manufacturing will experience in the future productivity growth far exceeding that of non-manufacturing activity, a case could be made for temporary quotas to protect British industries. Both logic and experience make me skeptical that such a bootstrap operation would raise U. K. real earnings or minimize their rate of decline. For France, West Germany, Canada, and United States, a similar verdict seems indicated.

Some protectionism must realistically be expected to be in the cards. Particularly as I warned in my 1972 little Nobel Lecture, "International Trade for a Rich Country" (SAMUELSON [1972]) it will be a bit like Marie Antoinette's admonition on diet to counsel the affluent nations to become headquarters economies, if the mutually-beneficial flow between countries of capital principals and earnings will be rendered impossible by sovereignties that refuse to tolerate or honor a code of foreign investments. If a rational global division of labor is inhibited by nationalistic opposition to foreign investment holdings, some manufacturing industry ought to remain in the affluent West. Under floating exchange rates the industrial nations will achieve the efficient kind of protection that economists approve of – namely, real exchange rate depreciation down to the point where domestic manufactures can still survive against import competition.

At this point *union* protectionism will loom as an important influence. In my own country, trade unions are not in a vibrant epoch of growth. Only in manufacturing and in government can they maintain a tenacious hold. With the electoral shift toward the right and toward contained government expenditures, union progress in the public industries has slowed down. Now the tendency for manufacturing to migrate also hits the unions in their heartland.

The economic effects of trade unions are difficult to agree upon. But this much is clear from the history of the railroad and coal sectors:

> *Unions are important in determining how an industry dies.* It is against their very nature for trade unions to engineer reductions in real wage rate to fend

off declines in employment. A Detroit worker may not be worth $ 18 an hour, compared to a Nagoyan worker paid $ 8 or a median American earner paid $ 10 or less. Even if maintenance of the auto builder's wage at levels of $ 18 an hour will gradually phase out much of the American industry, captains of the trade union ship will go down with all their flags flying, taking down all hands to sink with them. This is not because union officials are stupid or vicious. It is because they are human, determined to do what they have been created to do – to fight for highest possible wage conditions for their members.

The public at large, including median wage earners, knowing all about inequalities in a market economy and realizing that they each might win the lottery ticket of an $ 18 an hour job, are unlikely to judge the union officials and members harshly. The small self-interest of many in enjoying cheap imports weighs less as a political influence on legislators contemplating quotas than does the concerted self-interest of the few who work or invest in the auto and steel industries. Particularly is this so when most people fail to perceive that protecting a high paid job may actually be at the expense of *lowering average national real wage rates.*

We economists are needed, to weigh the costs and benefits and appraise the merits and demerits of the contending parties. This is an area where we can be proud of our craft.

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MASSACHUSETTS INSTITUTE OF TECHNOLOGY,
Cambridge, Mass., September 9, 1982.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C.

DEAR MR. GIBBONS: I am honored that you would consider my testimony before your committee on such an important matter as local content regulation of the U.S. auto market. However, based upon long-standing plans, I shall be away when you will most likely hold hearings, and therefore will not be able to offer personal testimony.

As you know, I have performed some research on the matter, largely based upon the original language in H.R. 5133. Therefore, I feel it important to clarify several points for the record.

1. My views and conclusions are solely my own, and should not be attributed to M.I.T., the Future of the Automobile Program, or any of its members.

2. The technical problems with local content regulation should not preclude taking some form of action vis-a-vis the American auto industry, or similar industries facing internationalization, While I do not agree with all of the proposals made by local content proponents, I feel they have done the nation a great service by highlighting a severe and long-term problem facing our industrial base. I also feel strongly that a company benefiting from sales in our market should participate appropriately in our economy, including participation in the costs of social adjustment caused by industrial transition; the U.S. should by no means foster policies which allow selective "loopholes" favoring foreign business, or which ignore the openness of our major markets to international trade. However, my work tells me that focused alternative policies—tax adjustments, humane labor adjustments, new tradeing policies, future-oriented energy and regulatory policies, and new policies toward the collective actions of U.S. companies in international trade—will be more beneficial than local content to workers, companies, consumers, the national economy, and the international trading structure.

3. I understand that portions of H.R. 5133 are likely to be re-drafted shortly, which may address many of my original concerns with the bill.

4. My fundamental conclusion remains this. A "sliding scale" local content regulation, based upon sales volume in the U.S. will tend, over the long term, to allow great freedom for importing producers, especially the Japanese. More importantly for the U.S. workforce and economy, such regulation would, in the global perspective, disproportionately restrict U.S. companies and their workers, compared to the foreign-based companies. This would occur at the very time U.S. companies need historic levels of flexibility to re-vitalize U.S. operations for long-term survival and jobs, and to balance their offshore divisions with U.S. ones to meet the growing offshore markets of the future, while withstanding the competitive pressures of their less-restricted competitors.

A legislative combination of relative freedom for importers, and relative restriction for U.S. companies contains much negative potential for U.S. workers, the companies employing them, and the portions of our economy which must internationalize for long-term survival.

The auto industry situation, and the broader problems it reflects, are serious and complex. The costs in human terms are now almost beyond calculation. I sincerely hope that we can solve these problems in the best national interest, without further factionalism, by building new policies to allow successful internationalization of our industries, and productive long-term jobs for our society. Based upon research extending beyond local content policies, I am confident that we can successfully resolve many of our long-term problems with alternative options providing better opportunities for workers and their companies now under international pressure. Should the Committee continue work in this area, I would be more than glad to offer assistance in any manner you might feel appropriate, through formal testimony or other means. I would also be extremely grateful if you could include my comments in the public record. Thank you once again for your consideration.

Sincerely,

MARTIN ANDERSON.

STATEMENT OF WARREN DAVIS, DIRECTOR OF GOVERNMENT RELATIONS, SEMICONDUCTOR INDUSTRY ASSOCIATION

This statement is being submitted on behalf of the Semiconductor Association (SIA) which has 54 member companies and represents the majority of merchant and captive producers of semiconductors in matters of trade and government policy.

SIA has testified before this Subcommittee on a number of occasions to outline our objectives for U.S. trade policy. Our central point has been that the semiconductor industry—one of America's leading high technology industries—is vitally dependent upon open conditions for international trade and investment. In our view, U.S. trade policy should be directed toward the elimination of foreign barriers and distortions to trade.

For this reason, SIA is opposed to the basic policy embodied in H.R. 5133, the Fair Practices in Automotive Products Act. In particular, SIA is concerned that the enactment of this legislation will lead other countries to adopt similar measures or to impose other barriers to U.S. exports of high technology products.

The U.S. semiconductor industry has proven its ability to compete internationally. In this respect, the semiconductor industry has recognized what all successful industries must appreciate, namely the importance of competing in world markets. Our markets are located in every major country of the world. The industry currently enjoys over 60 percent of the total world market for semiconductors. Export sales for a typical firm represent over 25 percent of total sales. Worldwide sales are essential to the production volumes we need to ride the learning curve toward dramatically lower costs and prices. Our record demonstrates that with every doubling of production volume, there is a 30 percent drop in costs. This dramatic decline in costs has stimulated demand and fostered the enormous growth of this industry over the past fifteen years.

Semiconductors are the basic building blocks of high technology. Without them, the extraordinary technological advances of the past two decades in such diverse fields as computers, data communications, robotics, office machinery, consumer electronics, space and advanced electronic weaponry would not have been possible. Because of their pervasive importance to the "lead edge" industries, as well as many older industries, they have been called "the crude oil of the 1980's."

It would be difficult to overstate the seriousness of the threat that this legislation poses for the semiconductor and other high technology industries. We are currently fighting an uphill battle against the increasing protectionist policies of many of our major trading partners. Everywhere we look, there is a proliferation of direct barriers or other government backed distortions that are designed to enhance the competitiveness of domestic industries at the expense of U.S. exports.

Local content is precisely the type of government regulation that is most damaging to our ability to compete abroad. Local content requirements replace individual decisions regarding the most efficient allocation of investment with government fiat. In the high technology industries, it is precisely the freedom to locate production where costs are lowest that has allowed the U.S industry to retain its competitiveness.

Local content requirements and other forms of investment related performance requirements pose some of the most serious barriers to semiconductor trade and investment. The United States has been a world leader in the fight to eliminate this type of restriction, most recently in its initiatives in the GATT ministerial which will convene in November. Adoption of this legislation would be a signal to other countries that the United States has abandoned this effort.

The semiconductor industry is very sensitive to the devastating impact the recession has had on the auto industry. Our industry is not impervious to general economic conditions. As one industry official stated recently, "This is one of the longest and most troubled periods in the history of electronics." The solution to this serious problem facing all American industry lies in the recovery of the economy as a whole. For this reason, SIA supported tax legislation to improve capital formation—including a tax credit for research and development—and to reduce the federal budget deficit. Our approach to international trade policy has been to press for further openness in international markets rather than a diminution in the access of foreign products to the U.S. market.

SIA's vision is that international trade and investment in high technology should be open and fair, and that excellence should be the sole determinant of success. Our point of departure for trade policy is that there is no good substitute for complete openness across international borders to international trade, investment and knowledge. As in no other area of international trade and investment, in knowledge-intensive goods there is a basic synergy that makes international exchange extraordinary beneficial. The flow of technology, trade and investment across borders benefits all nations.

We are also very aware of the competitive challenges which the Japanese pose for American industry. Automobiles are not the only sector facing stiff competition from the Japanese. Since the mid-1970's, the Japanese government has adopted a national goal—to achieve world dominance in the high technology industries, including computers, information processing, communications systems, and robotics.

The United States must develop an effective response to the Japanese policies which threaten American leadership in key industries. But the solution is not local content legislation. Although we do not claim to have all the answers to the problems facing the U.S. automobile industry, we believe there are forward-looking solutions to the international competitive challenge facing U.S. industries. SIA believes that part of the solution lies in the legislation currently pending before this Committee in H.R. 6773 and H.R. 6433.

H.R. 6433, the proposed "High Technology Trade Act of 1982" and H.R. 6773, the Reciprocal Trade and Investment Act of 1982 provide not only the negotiating mandate we in our industry need, but a far better and more effective approach to the trade problems faced by our nation than the domestic content legislation. These bills have been carefully formulated to provide an effective method of dealing with foreign industrial policies which distort international high technology trade and investment and other policies and measures which dissort trade or investment or deny national treatment to U.S. companies.

The purpose of the Trade Act of 1974, as it would be amended by these bills, is to seek maximum openness of international markets for U.S. trade and investment, through negotiated bilaterial and multilaterial agreements directed at eliminating distorting measures applied by foreign governments. The Act would authorize the President to negotiate agreements, which may include commitments to change U.S. laws or policies, and to alter U.S. laws, where necessary to carry out the agreements. The Act would provide for more vigorous use of the discretionary remedies under trade agreements and existing law, where negotiated solutions are not possible. Finally, it would establish an effective system to monitor the openness of foreign markets to U.S. high technology products, services, and investment.

SIA has played an active role in communicating to the government the problems facing the U.S. high technology industries, and in helping to formulate the approach to solving those problems which is incorporated in these bills. We are optimistic that the carefully constructed package of measures concerning high technology will prove to be an effective means of dealing with problems of high technology trade and investment.

The components of this package have been incorporated in Senator Danforth's bill (2094), recently reported out of the Senate Finance Committee. Congressman Frenzel's bill (H.R. 6773), before this subcommittee now, is a companion bill to the Danforth bill, and mirrors it in every respect, with the unfortunate exception of the limited but important tariff-cutting authority (addressing certain high technology products) presently in the senate bill.*

To restrict trade is ultimately self-defeating. When the Japanese chose to restrict minicomputer imports in the early 1970's, they slowed progress in many of their domestic industries, limited the evolution of the applications for computers in Japan, and weakened the development of the software industry in Japan. Today, Mexico and Brazil are seeking to take a great step forward into the high value-added, knowledge intensive industries, but are jeopardizing the success of this transition by imposing stringent performance requirements. A failure to respond to this new incidence of mercantilism—particularly prevalent in the high technology field—would adversely affect each individual nation and the international system as a whole. In our highly interdependent international economic system, maximum worldwide development of high technology is undeniably in the best interests of all. To adopt short-sighted policies focused exclusively on national achievement is to divert us from the path of maximum efficiency and progress, and can only be counterproductive.

Elimination of the barriers to free international trade and investment can be the only logical goal in this sector for any nation. The global economies of scale and the access to capital essential to any viable high technology industry can only be achieved if market restrictions are eliminated. Moreover, except through fair international competition, the level of dynamic creativity so vital to American industry cannot be tested, and, therefore, cannot be fully developed.

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*In testimony before the Senate International Trade Subcommittee last March, USTR William E. Brock emphasized the need for this authority, stating: Focus should be directed toward the need for multilaterial consideration of high technology trade. I ask that Congress examine the reduction of barriers to trade in high technology goods, including the reduction of tariffs. Such a provision would give the President specific authority to reduce U.S. tariffs on high technology products in exchange for equivalent concessions.

High technology products and industries occupy a unique position in every contemporary national economy. Because of their diverse and pervasive uses, measures which deter progress in this area by restricting international free trade and investment in high technology, ultimately deter progress in a whole range of important industries. Therefore, we should be especially careful in crafting remedies for the problems facing industries, such as automobiles, not to encourage the creation of additional barriers abroad for our high technology industries.

To persist in restricting market access and seeking to expand exports would be an ultimately fruitless effort for any nation. Even purely national goals are not likely to be achieved in the current atmosphere. Developed and advanced developing nations alike would soon find foreign markets closed to them.

The combination of legislative measures in the bills before you—H.R. 6433 and H.R. 6773—together with existing authorities contain many of the ingredients necessary for achieving substantial progress in dealing with the problems not only of high technology trade and investment but of American industry and agriculture in general, and may form the foundation for comprehensive, multilateral solutions. These measures are urgently needed, and we emphasize the importance of their early enactment. They provide an alternative to local content legislation and a much more effective and forward looking approach to the problems facing American industries in their efforts to compete internationally.

STATEMENT OF DAVID J. STEINBERG, PRESIDENT, U.S. COUNCIL FOR AN OPEN WORLD ECONOMY, INC.

(The U.S. Council for an Open World Economy is a private, nonprofit, public-interest organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any private interest.)

H.R. 5133 (deceptively named the Fair Practices in Automotive Products Act) would establish minimum domestic-content requirements for the sale of automobiles in the United States. Designed by the automobile workers union to regain for unemployed U.S. auto workers the jobs they have lost in recent years as foreign manufacturers won unprecedentedly large shares of the massively changed U.S. automobile market, this bill would be abysmally counterproductive. It would also pose severe, costly administrative burdens for U.S. auto makers, foreign auto makers, and U.S. government officials entrusted with enforcement of such legislation. The terms I used in opposing the original "reciprocity" bill introduced this year in the Senate are no less apt (in fact, more so) in describing domestic-content legislation: H.R. 5133 would be a cross between a Pandora's box and a can of worms—a cross which the American economy, and the U.S. auto industry itself, should not have to bear.

To the extent that it significantly reduced U.S. auto imports rather than just rearranged the pattern of current levels of auto imports, such legislation would restore jobs to some unemployed U.S. auto workers (and some workers in related industries) at the cost of good jobs that would be lost to other sectors of the U.S. labor force (including many in the auto workers union itself). This offsetting loss of jobs would result from the loss of U.S. exports in the wake of foreign emulation of such domestic-content practices (few countries currently have such rules), retaliation against such requirements by countries directly affected by these U.S. import curbs, and reduction of foreign purchasing power as world trade and income declined. Such legislation would clearly be in violation of the international code of fair competition (the General Agreement on Tariffs and Trade), and would impair the efforts the United States is making to gain and sustain freer access to major foreign markets (including major automobile-producing countries) for goods in which our economy excels.

Such legislation, establishing the highest domestic content quotas (as high as 90 percent) for auto producers with the largest sales in the U.S. Market, would seriously obstruct efforts the U.S. auto makers are making (and should never cease making) to market automobiles of the highest quality and at the lowest possible price. It would obstruct these efforts by seriously curtailing the flexibility of these manufacturers in their choice of sources of supply for the multiplicity of parts that go into production of automobiles. Although the ingredients of domestic content (as defined in the latest version of the bill) include advertising and other items that are not "blue collar" production costs, thus tending to lessen the domestic-content requirements for American-made parts, this in no way redeems the bill.

In view of the emulatory and retaliatory implications of such legislation for U.S. exports of a wide range of manufactured goods in which this country has a highly rewarding export business, the long-term tendency would be for the United States to become less and less an exporter of manufactures, and proportionately more an exporter of agricultural and mineral products, as increasing numbers of countries followed our example in setting domestic-contents rules. It would be unrealistic to assume that automobiles would be the alpha and omega of U.S. recourse to such practices. Other sectors of our economy would be likely to seek similar privileges and immunities.

The U.S. labor movement, concerned over the United States losing its impressive shares of world markets in industrial goods and possibly becoming predominantly an exporter of crude materials, should be opposed to bills like H.R. 5133. The fact that the U.S. labor movement (not just the auto workers) supports and indeed campaigns for this bill—legislation involving heavy costs to the nation as a whole and to many sectors of the labor movement's own constituency—suggests that the American labor movement may be sinking into a policy bankruptcy that impairs, not only the nation's enlightened self-interest, but also the credibility of the labor movement's concern for the national interest and the wisdom of its positions on other issues.

When the adverse implications of domestic-content legislation for U.S. inflation, productivity, trade policy and overall foreign policy are considered, it is hard to believe that the prime mover behind this bill is the same labor movement that has done so much—often ahead of other sectors of our society—to advance the nation's best interests. As an old friend of the American labor movement, I continue to expect great things from it. There is much that labor can and should do to prod the government, the business establishment and the public at large to face up to the nation's most pressing needs with deliberate speed and intelligence ingenuity, and in a manner consistent with the nation's highest ideals. With this bill, labor is letting the nation down.

Strong criticism should also be directed at the Administration for not having a coherent domestic redevelopment, full-employment strategy which could have raised the sights of the auto workers, the labor movement in general and the nation as a whole to enlightened policies and objectives that would have diverted energies away from radically regressive propositions diverted energies away from radically regressive propositions such as the policy abomination advocated in this bill. No less deserving of criticism is the "liberal trade" movement itself for not campaigning for such a redevelopment strategy, which is indispensable, not only to free-trade strategy that our Council alone has urged, but to the less far-reaching "freer trade goals with which the "liberal trade" movement as a whole is identified.

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